

No. 15270

---

United States  
Court of Appeals  
for the Ninth Circuit

---

ROBERT AZEVEDO, IRENE KERSHAW and  
PAUL KERSHAW, JR.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

---

Transcript of Record

---

Petition to Review Decisions of the Tax Court  
of the United States

FILED

DEC 26 1956



No. 15270

---

United States  
Court of Appeals  
for the Ninth Circuit

---

ROBERT AZEVEDO, IRENE KERSHAW and  
PAUL KERSHAW, JR.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

---

Transcript of Record

---

Petition to Review Decisions of the Tax Court  
of the United States





## INDEX

---

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

### PAGE

Amendment to Petition .....	26
Answer .....	23
Answer to Petition as Amended .....	27
Appearances .....	1
Certificate of Clerk .....	187
Decision Re Robert Azevedo .....	77
Decision Re Irene Kershaw .....	78
Decision Re Paul Kershaw, Jr. ....	79
Letter Re Error in Petition for Review .....	85
Memorandum Findings of Fact and Opinion ..	45
Petition .....	3
Ex. A—Notice of Deficiency .....	13
B—Agreement .....	20
C—Agreement .....	22
Petition for Review .....	80
Reply to Respondent's Answer to Petition as Amended .....	29

INDEX	PAGE
Second Answer to Petition as Amended . . . . .	30
Statement of Points . . . . .	189
Stipulation Re Consolidation . . . . .	191
Stipulation Re Exhibits . . . . .	193
Stipulation of Facts . . . . .	32
Transcript of Proceedings . . . . .	89
Opening Statement on Behalf of the Petitioner . . . . .	96
Opening Statement on Behalf of the Respondent . . . . .	103
Witnesses:	
Burstein, Robert C.	
—direct . . . . .	169
Kershaw, Paul, Jr.	
—direct . . . . .	132
—cross . . . . .	169

## APPEARANCES

ROBERT C. BURNSTEIN,

414 13th St.,

Oakland, Calif.,

For the Petitioners.

CHARLES K. RICE,

Asst. U. S. Attorney General,

LEE A. JACKSON, Attorney,

Department of Justice,

Washington 25, D. C.

For the Respondent.



The Tax Court of the United States

Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau Symbols—ADC: Ap: LA-SF: HTM: EMW: 90-D) Dated May 13, 1953, and as a basis of his proceedings alleges as follows:

1. The petitioner is an individual with residence at Route 2, Box 2851B, Sacramento, California. The return for the period here involved was filed with the Collector for the First California District.

2. The Notice of Deficiency, a copy of which is attached hereto and marked Exhibit "A," and made a part hereof as if set forth in full herein, was mailed to petitioner on May 13, 1953.

3. The deficiency, as determined by the Commissioner is in Income Taxes for the calendar year 1946 in the amount of Twenty-Five Thousand Nine Hundred Forty-Three and 07/100 Dollars (\$25,-943.07) of which all is in dispute.

4. The determination of tax set forth in said Notice of Deficiency is based upon the following errors:

(a) The Commissioner has erroneously found that the profits from the sale of wine from March 4th through August 6, 1946, was to be considered as those of a single proprietor of one John Azevedo with the net income allocated to Robert Azevedo and Paul Kershaw, Jr. in equal shares, since the Commissioner erred in its Findings that the corporation Mills Winery had no legal right to sell wine at wholesale without Basic Permits from the Alcoholic Tax Unit of the Bureau of Internal Revenue of the United States.

(b) The Commissioner has erred in allocating the profits from the sale of wine from March 4th, to August 6, 1946, to Robert Azevedo and Paul Kershaw, Jr., since such allocation of income to the said Robert Azevedo and Paul Kershaw, Jr., would constitute a recognition of said Robert Azevedo and Paul Kershaw, Jr., as copartners or as individuals being entitled to such profits resulting from the sale of wine without a permit being held by the said Robert Azevedo or Paul Kershaw, Jr., individually or as copartners from the Alcoholic Tax Unit of the Bureau of Internal Revenue of the United States and is thus, inconsistent with the major premises of the Commissioner in fixing and determining the deficiency herein since the major premises of the Commissioner in not recognizing such profits during the said period as corporate income, was the

fact that the corporation, Mills Winery, had not obtained a Basic Permit from the Alcoholic Tax Unit of the Bureau of Internal Revenue of the United States.

(c) The Commissioner has erred in that there was a failure to distinguish between the operation of a Winery and/or Distillery and the mere sale of wine at wholesale which was purchased by the corporation, Mills Winery, at one instance and sold at various times from March 4th to August 6, 1946.

(d) The Commissioner has erroneously disregarded the separate entity of Mills Winery, a California corporation, incorporated March 4, 1946, from the date of said incorporation to and including August 6, 1946.

(e) The Commissioner erroneously concluded that the separate entity, Mills Winery, a California corporation was dormant during the period from March 4th, to August 6, 1946.

(f) The Commissioner has erroneously interpreted the significance and meaning of certain contracts entered into between John Azevedo and Robert Azevedo and Paul Kershaw, Jr., dated December 1, 1945, and marked Exhibits "B" and "C," respectively, attached hereto and made a part hereof as if set forth in full herein in light of the conduct of said parties subsequent and prior to the execution of said agreements. Such conduct clearly evidencing ownership of wine by Robert Azevedo and



Paul Kershaw, Jr., as copartners to March 1, 1946, and thereafter, was erroneously disregarded by the Commissioner when determining the true ownership of the wine sold from March 4, 1946, to August 6, 1946.

5. The facts upon which the petitioner relies as the basis of this proceeding, are as follows:

(a) Robert Azevedo and Paul Kershaw, Jr., engaged in a copartnership business from August 1, 1945, to March 1, 1946, under the firm name and style of Mills Winery and filed with the Collector of the First California District, a partnership income tax return for said period.

(b) Mills Winery, a California corporation was organized under and by virtue of the laws of the State of California on March 4, 1946, with Robert Azevedo and Paul Kershaw, Jr., being two of the three original incorporators. The Corporation acquired at the time of its incorporation, the total bulk wine inventory of the copartnership of Robert Azevedo and Paul Kershaw, Jr., doing business under the firm name and style of Mills Winery and that said inventory at the beginning of the corporate fiscal year was the total inventory at the close of the said copartnership. This information appeared in the amended United States Corporation Income Tax Return of Mills Winery for February 28, 1946, to February 28, 1947, and the copartnership return of Income filed by Robert Azevedo and



Paul Kershaw, Jr., for the period of the existence of said copartnership terminating February 28, 1946.

(c) Mills Winery, a California corporation, filed its corporate return for the above fiscal year set forth in subdivision (b) above, with the Collector for the First California District and further filed for said period its State of California Bank and Corporation Franchise Tax Return with the Franchise Tax Commissioner of the State of California which likewise, reported the opening inventory of the corporation, Mills Winery as the inventory obtained from the partnership conducted by Robert Azevedo and Paul Kershaw, Jr.

(d) Mills Winery, a California corporation, on or about March 4, 1946, acquired from a single purchase from Robert Azevedo and Paul Kershaw, Jr., copartners, all the bulk wine premises which was the only purchase of wine made by the said corporation during the periods of March 4 to August 6, 1946.

(e) Mills Winery, a California corporation was not regularly engaged in the business of purchasing for resale at wholesale, bulk wine during the period of March 4, 1946, to August 6, 1946, but during said period Mills Winery, a California corporation made several sales of wine from the single purchase made by said corporation from Robert Azevedo and Paul Kershaw, Jr., on or about March 4, 1946.

(f) Mills Winery, a California corporation, did not have, during the period from March 4th to

August 6, 1946, a permit from the Alcoholic Tax Unit from the Bureau of Internal Revenue of the United States to act as a Winery and/or distillery. This corporation did not, during said period, engage in business as a winery and/or distillery but merely sold several parcels of wine that was purchased by the corporation in one single purchase.

(g) After March 4, 1946, namely on May 11, 1946, and on May 23, 1946, Mills Winery, a California corporation, entered into written agreements with Southern Pacific Company wherein the Mills Winery, as a California corporation, granted a license to the said Railroad "Private Road Crossing Tracks at a Grade," said agreements are attached hereto and marked Exhibits "D" and "E," respectively, and made a part hereof as if set forth in full herein.

(h) After March 4, 1946, and namely, on June 21, 1946, Mills Winery in its corporate capacity, became the owner of the real property upon which the wine premises and equipment were located, said corporate ownership was obtained by a Grant Deed by John and Frances Azevedo as Grantors and Mills Winery, a California corporation, as Grantee, said Deed was duly recorded in Volume 1294 at Page 351, of the Official Records of Sacramento County, California.

(i) From and after March 4, 1946, all wine brokers in the Oakland-San Francisco Bay Area dealt with Paul Kershaw, Jr., and Robert Azevedo

as officers of a California corporation representing said corporation that owned and held bulk wine to be sold in the open market, at wholesale.

(j) Mills Winery, a California corporation, after March 4, 1946, and namely, on April 9, 1946, entered into a written agreement with various owners of a Fruit Pulping Machine for the manufacture and sale of fruit spirits.

(k) Mills Winery, a California corporation, employed a responsible managing employee to conduct the office affairs of said corporation in April, 1946; said employee, namely, A. H. Becker, now executive director of the Federal Housing in the City of Sacramento, State of California, continuously dealt with growers, wine manufacturers and distillers, fruit processors, brokers and all persons interested in or connected with the fruit processing industries on behalf of Mills Winery, a California corporation; that all the affairs of the corporation going through the office located at the wine premises relating to the sales of wine and business dealings with those interested in the fruit processing industry, were within the knowledge of said employee from April, 1946, to January, 1950, and all such persons dealing with the office manager named herein dealt with him as an employee of Mills Winery, a California corporation.

(l) Robert Azevedo and Paul Kershaw, Jr., entered into written agreements with John Azevedo for the purchase of the winery as is more specifically

set forth in exhibits "B" and "C" to this petition hereinbefore referred to and made a part hereof but said agreements did not, in its terms prohibit the operation of Mills Winery, a California corporation in the sale of wine as distinguished from the operation of a winery which is a manufacturer of wine and distiller of spirits.

(m) Robert Azevedo and Paul Kershaw, Jr., at the time of the contracts, as set forth in exhibits "B" and "C," were executed conducted the operations at the winery premises as a copartnership. These operations did not constitute during the period of the copartnership the manufacture of wine. However, they accumulated an inventory of wine from the John Azevedo winery operation in the 1945 grape crush over which they exercised dominion and control as copartners. This wine inventory was turned over to Mills Winery, a California corporation, on or about March 4, 1946, by the copartners, Robert Azevedo and Paul Kershaw, Jr., who had at that time ceased all operations as copartners. From and after March 4, 1946, the sale of said inventory was made by the corporation to various purchasers by the corporation in its corporate capacity.

(n) The contracts entered into between Robert Azevedo, Paul Kershaw, Jr., and John Azevedo, as set forth in said exhibits "B" and "C," contemplated the copartnership operation between Robert Azevedo and Paul Kershaw, Jr., until the winery and/or distillery Basic Permits could be obtained by

Robert Azevedo and Paul Kershaw, Jr. However, the parties changed the form of their business organization on March 4, 1946, to dispose of the wine inventory and in order to operate in this regard as a corporation and not as a copartnership, the individuals did not apply for a Basic Permit but the corporation in May, 1946, did apply for such a permit and a permit was granted to the corporation.

(o) All the benefits of ownership and all the burdens of ownership of the wine inventory were transferred to the corporation. During the period of March 4th, to August 6, 1946, all moneys received from the sale of wine were deposited in a single bank account which was during said period subject to withdrawal by John Azevedo. All expenditures for the benefit of the winery during that period which were paid during that period came from this single bank account. All moneys except those sums which were spent for the actual benefit of the corporation were kept intact in this single bank account. The only difference between this bank account as it existed from March 4th, to August 6, 1946, and after August 6, 1946, was that additional signatures were filed with the bank as authorized signatures for withdrawal. Prior to August 6, 1946, and from March 4, 1946, when John Azevedo's name was the only authorized signature filed with the bank, withdrawals were made by the said John Azevedo only at the direction of the corporate officers and only for corporate purposes designated by the corporate officers. All obligations incurred during the period



of March 4, 1946, to August 6, 1946, and thereafter were paid from moneys in this single bank account. Obligations that were incurred between March 4th to August 6, 1946, for repairs, remodeling, alterations and additions to the winery premises were paid from this account before and after August 6, 1946.

(p) On or about March 4, 1946, corporate books and accounts were opened by the accountant for Mills Winery, a California corporation, that all sales of wine made during that period were picked up as corporate gross profit. All expenditures that were made after said date were picked up as corporate expenditures and said corporate books, from March 4th, to this day have been without any interruption reporting all sales, expenditures and assets of the corporation, Mills Winery, a true and correct reflection of all such matters reported to the United States Government by the Corporation Income Tax return and to the State of California by the Franchise Tax return.

Wherefore, the petitioner prays that this Court may hear the proceedings and determine that the Commissioner has erred in asserting that there is a deficiency due for the year 1946.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Duly verified.

**EXHIBIT "A"**

Los Angeles District-Appellate Division  
Room 710—630 Sansome Street  
San Francisco 11, California

May 13, 1953.

ADC:Ap:LA

SF:HTM:EWM:90-D

Mr. Paul Kershaw, Jr.,  
Route 2, Box 2851B,  
Sacramento, California.

Dear Mr. Kershaw:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1946, discloses a deficiency of \$25,-943.07, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days, you may not exclude any day unless the 90th day is a Saturday, Sunday or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise, Saturdays, Sundays and legal holi-

days are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant District Commissioner, Appellate, Room 710, 630 Sansome Street, San Francisco 11, California. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is earlier.

Very truly yours,

T. COLEMAN ANDREWS,  
Commissioner;

By /s/ WM. G. WILKER,  
Assistant Head, Appellate  
Division.

Enclosures:

Statement

Form 1276

Agreement Form



ADC:Ap:LA  
SF:HTM:EWM:90-D

## Statement

Mr. Paul Kershaw, Jr.  
Route 2, Box 2851 B  
Sacramento, California

Tax liability for the taxable year ended December 31, 1946:

	Deficiency
Income Tax .....	\$25,943.07

In making this determination of your income tax liability, careful consideration has been given to your protest dated May 21, 1952, and to the statements made at the conference held on August 22, 1952.

The five-year period of limitation for assessment provided in section 275(c) of the Internal Revenue Code is held to be applicable to the taxable year ended December 31, 1946, since there was an omission from gross income of an amount which was in excess of 25% of the amount of gross income shown on the return.

A copy of this letter and statement has been mailed to your representative, Mr. Robert C. Burnstein, 414 Thirteenth Street, Oakland 12, California, in accordance with the authority contained in the power of attorney executed by you.

## Adjustment to Net Income

Year: 1946

Net income as disclosed by the original return .....	\$ 5,986.03
Unallowable deductions and additional income:	
(a) Adjustment of income from operation of Mills Winery.....	50,528.46
(b) Correction of error on page 1 of return .....	.40
(c) Adjustment of business loss....	1,720.75
Total .....	<hr/> \$ 58,235.64

## Nontaxable income and additional deductions:

(d) Adjustment of capital gain on sale of business.....	345.99	
(e) Adjustment of income from wages .....	5,000.00	5,345.99
		<hr/>
Net income as adjusted.....		\$ 52,889.65

## Explanation of Adjustments

(a) Earnings from operation of Mills Winery as shown by the return .....	None
As revised .....	\$ 50,528.46
	<hr/>
Increase in net income .....	\$ 50,528.46

It is held that the earnings from the operation of the business known as "Mills Winery" for the period from January 1, 1946, to August 6, 1946, are taxable to you as your share of community income as shown in the statement submitted herewith.

## Statement of Income

## Mills Winery

January 1, 1946, through August 6, 1946

Sales .....	\$693,114.80
Cost of sales .....	445,467.09
	<hr/>
Gross profit .....	\$247,647.71

## Expenses:

Supplies .....	\$ 2,703.98
Commissions .....	12,179.00
Freight .....	45.68
C. M. O. Tax.....	1,854.83
Labor .....	4,848.26
Utilities .....	822.47
Oil Fuel .....	236.91
Office Expense .....	428.71
Bonded Warehouse, legal.....	5,538.64
Audit expense .....	54.60
Advertising .....	180.88

Statement of Income—Mills Winery  
(Continued)

Traveling .....	308.18	
Licenses, tax .....	344.63	
S. S. Tax .....	37.87	
Unemployment .....	102.25	
Property Tax .....	520.36	
Miscellaneous Taxes .....	490.34	
Repairs .....	10,782.32	
Interest .....	469.72	
Depreciation .....	3,564.26	\$ 45,533.89
		<hr/>
Net Profit .....		\$202,113.82
		<hr/> <hr/>
Distributable		
Robert Azevedo .....		\$101,056.91
Paul Kershaw, Jr. ....		101,056.91
		<hr/>
		\$202,113.82
Distributable income of Paul Kershaw, Jr., as shown above .....		\$101,056.91
Community share taxable to wife.....		50,528.45
		<hr/>
Community share taxable to husband....		\$50,528.46

(b) Net income is increased by \$0.40, representing a correction of the amount of the loss (income from other sources), carried over to page 1 of your return from page 2.

It is held that all income received by you and your wife represents community income, one-half of which is taxable to each. In accordance therewith, the following adjustments to income have been made as explained in items (c), (d) and (e):

(c) Loss from business claimed on  
the return of

Paul Kershaw, Jr. ....	\$ 4,205.55
Loss from business claimed on the return of Irene Kershaw..	764.06
	<hr/>

Total business loss of both taxpayers .....	\$ 4,969.61
--	-------------

---

Statement of Income—Mills Winery  
(Continued)

Your community one-half.....	\$ 2,484.80
Business loss claimed on your return .....	\$ 4,205.55
	<hr/>
Increase in net income.....	\$ 1,720.75
(d) Capital gain on sale of business shown by the return of	
Paul Kershaw, Jr. ....	691.98
Capital gain shown on the re- turn of Irene Kershaw.....	None
	<hr/>
Total capital gain of both taxpayers .....	\$ 691.98
Your community one-half.....	345.99
Capital gain shown on your return .....	691.98
	<hr/>
Decrease in net income.....	\$ 345.99
(e) Wages and salary income shown on the return of Paul Kershaw, Jr. ....	
	\$10,000.00
Wages and salary income shown on the return of Irene Kershaw .....	None
	<hr/>
Total wages and salary income of both taxpayers.....	\$10,000.00
	<hr/>
Your community one-half.....	\$ 5,000.00
Wages and salary income shown on your return.....	10,000.00
	<hr/>
Decrease in net income.....	\$ 5,000.00

Computation of Income Tax

Net income .....	\$52,889.65	
Less: Exemption .....	500.00	
<hr/>		
Normal tax and surtax net income.....	\$52,389.65	
Tentative tax on \$52,389.65.....		\$ 28,612.23
Less: 5% reduction .....		1,430.61
<hr/>		
Total income tax.....		\$ 27,181.62
<hr/>		
Total alternative tax .....		\$ 27,108.10
<hr/>		
Income tax liability.....		\$ 27,108.10
Income tax liability disclosed by original return Account No. 8100301, First California District .....		1,165.03
<hr/>		
Deficiency in income .....		\$ 25,943.07

Computation of Alternative Tax

Net income .....	\$52,889.65	
Less:		
Excess of net long-term capital gain over net short-gain capital loss.....	345.99	
<hr/>		
Ordinary net income.....	\$52,543.66	
Less:		
One exemption at \$500.....	500.00	
<hr/>		
Normal tax and surtax net income.....	\$52,043.66	
Tentative tax on \$52,043.66.....		\$ 28,352.74
Less: 5% Reduction.....		1,417.64
<hr/>		
Balance of tentative tax.....		\$ 26,935.10
50% of excess of net long-term capital gain over net short-term capital loss..		173.00
<hr/>		
Alternative tax .....		\$ 27,108.10
<hr/>		

## EXHIBIT "B"

## Agreement

This Agreement, made this 1st day of December, 1945, by and between John Azevedo, Party of the first part, hereinafter called "seller," and Robert Azevedo and Paul Kershaw, Jr., Parties of the second part, hereinafter called "purchasers." Witnesseth:

Whereas first party is desirous of selling to second parties that certain winery known as "Mills Winery" located at Mills Junction, California, and all the assets pertaining thereto; and,

Whereas, second parties are desirous of purchasing the same;

Now, therefore, in consideration of the mutual promises of the parties hereto, this agreement:

1. It is mutually understood and agreed by and between the parties that seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.

2. Purchasers agree to purchase said winery hereinabove mentioned under the terms and conditions stated in paragraph 1, above.

3. It is mutually understood and agreed that seller shall remain the owner of said winery until



such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same; provided, however, that purchasers shall, on January 1, 1946, operate and manage said winery for seller until said time as purchasers shall be able to make actual purchase of said winery, provided further that the compensation for said management, purchasers shall receive as salary the earnings of said business during said period of management.

4. It is further mutually agreed and understood by the parties hereto that unless the above-mentioned permits are issued in the names of purchasers on or before January 1, 1947, this agreement shall at the option of seller be declared null and void.

5. It is hereby understood and agreed by the parties hereto that this agreement shall apply not only to the parties hereto but to their assigns.

In Witness Whereof, the parties hereto have hereunto set their hands the day and year first above written.

/s/ JOHN AZEVEDO,

ROBERT AZEVEDO,

PAUL KERSHAW, JR.

## EXHIBIT "C"

This Agreement made and entered into this 1st day of December, 1945, by John Azevedo, doing business as the Mills Winery and, Paul Kershaw, Jr., and Robert J. Azevedo.

Whereas for a consideration, John Azevedo is selling the Mills Winery and all its assets to Paul Kershaw, Jr., and Robert J. Azevedo.

And, whereas, as owner and operator of the Mills Winery, John Azevedo has contracted obligations since August 1st, 1945. Now, as part of the consideration above referred to Paul Kershaw, Jr., and Robert J. Azevedo agree to assume and pay any judgment or judgments which may arise from Court Action or otherwise or operation of same Mills Winery between August 1, 1945, and up to and including date of actual transfer of the physical assets of the Mills Winery which will be the time that the United States Government issues to Paul Kershaw, Jr., and Robert J. Azevedo a Basic Permit to operate said Winery.

Signed: .....

Signed: .....

Received and Filed August 3, 1953, T.C.U.S.

Served August 4, 1953.



[Title of Tax Court and Cause.]

### ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Kenneth, W. Gemmill, Acting Chief Counsel, Internal Revenue Service, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1, 2 and 3. Admits the allegations in paragraphs 1, 2 and 3.

4(a) to (f), inclusive. Denies the allegations of error in subparagraphs (a) to (f), inclusive, of paragraph 4.

5(a). For lack of information, denies the allegations in subparagraph (a) of paragraph 5.

(b). Admits that Mills Winery, a California corporation, was organized under and by virtue of the laws of the State of California on March 4, 1946, with Robert Azevedo and Paul Kershaw, Jr., being two of the three original incorporators; for lack of information, denies the remaining allegations in subparagraph (b) of paragraph 5.

(c), (d) and (e). For lack of information, denies the allegations in subparagraphs (c), (d) and (e) of paragraph 5.

(f). Admits that Mills Winery, a California corporation, did not have, during the period from March 4th, to August 6, 1946, a permit from the

Alcoholic Tax Unit from the Bureau of Internal Revenue of the United States to act as a winery and/or distillery; admits that this corporation did not, during said period, engage in business as a winery and/or distillery; denies the remaining allegations in subparagraph (f) of paragraph 5.

(g). Admits the allegations in subparagraph (g) of paragraph 5.

(h). Admits the allegations in subparagraph (h) of paragraph 5, except denies that on June 21, 1946, Mills Winery, in its corporate capacity, became the owner of the real property.

(i) and (j). For lack of information, denies the allegations in subparagraphs (i) and (j) of paragraph 5.

(k). Admits that Mills Winery, a California corporation, employed a responsible managing employee to conduct the office affairs of said corporation April, 1946; said employee, namely A. H. Becker, now executive director of the Federal Housing in the City of Sacramento, State of California, continuously dealt with growers, wine manufacturers and distillers, fruit processors, wine brokers and all persons interested in or connected with the fruit processing industries; denies the remaining allegations in subparagraph (k) of paragraph 5.

(l). Admits that Robert Azevedo and Paul Ker-shaw, Jr., entered into written agreements with John Azevedo for the purchase of the winery as is more specifically set forth in Exhibits "B" and

“C,” to this petition; denies the remaining allegations in subparagraph (l) of paragraph 5.

(m) and (n). For lack of information, denies the allegations in subparagraphs (m) and (n) of paragraph 5.

(o). Admits that during the period of March 4th, to August 6, 1946, all moneys received from the sale of wine were deposited in a single bank account which was, during said period, subject to withdrawal by John Azevedo; admits that prior to August 6, 1946, and from March 4, 1946, when John Azevedo's name was the only authorized signature filed with the bank, withdrawals were made by the said John Azevedo; denies the remaining allegations in subparagraph (o) of paragraph 5.

(p). Admits that on or about March 4, 1946, corporate books and accounts were opened by the accountant for Mills Winery, a California corporation, that all sales of wine made during that period were picked up as corporate gross profit; admits that all expenditures that were made after said date were picked up as corporate expenditures and said corporate books, from March 4th, to this day have been without any interruption reporting all sales, expenditures and assets of the corporation, Mills Winery; for lack of information, denies the remaining allegations in subparagraph (p) of paragraph 5.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination in all respects be approved and the petitioner's appeal denied.

/s/ KENNETH W. GEMMILL,  
Acting Chief Counsel,  
Internal Revenue Service.

Filed September 9, 1953, T.C.U.S.

---

[Title of Tax Court and Cause.]

### AMENDMENT TO PETITION

The court having heretofore granted to Petitioner leave to file an Amendment to his Petition heretofore filed with the above-entitled Court, the Petitioner herein does hereby amend the Petition heretofore filed by him with the above-entitled Court by adding to said Petition, Paragraphs 4-G and 5-Q, and does allege as follows:

4-G. The assessment of the deficiency as determined by the Commissioner is barred by the Statutes of Limitation, namely, Section 275, Subdivision (a) of the Internal Revenue Code as effective during the calendar year of 1947.

5-Q. That more than three years elapsed since the filing of the Income Tax Return by Petitioner for the calendar year 1946 and the determination and filing of the deficiency assessment by the Commissioner.

Wherefore, Petitioner prays that this Court may hear the proceedings and determine that the Commissioner has erred in asserting that there is a deficiency due for the year 1946.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Duly verified.

Received and Filed July 21, 1955, T.C.U.S.

Served July 21, 1955.

---

[Title of Tax Court and Cause.]

## ANSWER TO PETITION AS AMENDED

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, pursuant to leave heretofore granted, and for answer to petition as amended and filed by the above-named petitioner, denies and alleges as follows:

4-G. Denies the allegations of error in subparagraph G of paragraph 4 of the Amendment to Petition.

5-Q. Denies the allegations in subparagraph Q of paragraph 5 of the Amendment to Petition.

7. Further answering the petition as amended, respondent alleges as follows:



(a) That petitioner omitted from gross income as reported on his income tax return for 1946 an amount properly includible therein, which is in excess of 25% of the amount of said gross income stated in said return.

(b) That if the earnings from the operation of the business known as "Mills Winery," for the period January 1, 1946, to August 6, 1946, in the amount of \$50,528.46 are held not taxable to petitioner, then, in the alternative, petitioner received a constructive dividend in the amount of \$27,500.00 by reason of the payment and satisfaction by "Mills Winery" of a debt owing by petitioner to John Azevedo.

Wherefore, it is prayed:

(1) That petitioner's appeal be denied and the Commissioner's determination in all respects be approved.

(2) That the Court determine that the assessment of deficiencies is not barred by the statute of limitations.

/s/ JOHN POTTS BARNES,  
Chief Counsel,  
Internal Revenue Service.

Filed August 23, 1955, T.C.U.S.

Served August 24, 1955.

[Title of Tax Court and Cause.]

REPLY TO RESPONDENT'S ANSWER TO  
PETITION AS AMENDED

Comes now the above-named Petitioner for reply to the allegations affirmatively set out by the Respondent in his answer, admits, denies and alleges as follows:

7(a). Denies each and every, all and singular, generally and specifically the allegations contained in Subparagraph (a) of Paragraph "7" of the Respondent's Answer to the Petition as Amended.

Further answering said Subparagraph (a) of Paragraph "7" of Commissioner of Internal Revenue's Answer to Petition as Amended, this Petitioner alleges that he did not omit from his gross income as reported on his income tax for 1946 an amount properly includible therein which is in excess of Twenty-Five Per Cent (25%) or any other sum or at all of the amount of said gross income stated in said return.

7(b). This Petitioner denies each and every, all and singular, generally and specifically the allegations contained in Subparagraph (b) of Paragraph "7" of the Commissioner's Answer to the Petition as amended.

Further answering said Subparagraph (b) of paragraph "7," this Petitioner alleges that he did not receive a constructive dividend in the amount of Fifty-Five Thousand Dollars (\$55,000.00) or any other sum at all.

Further answering said Subparagraph (b) of Paragraph "7," this Petitioner denies that the sum of Fifty-Five Thousand Dollars (\$55,000.00) or any other sum was paid by Mills Winery for the satisfaction of a debt owing by Petitioner to John Azevedo.

Wherefore, Petitioner prays that this Court determine that the Commissioner has erred in asserting that there is any deficiency due for the year 1946.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Duly verified.

Received and Filed September 12, 1955, T.C.U.S

---

[Title of Tax Court and Cause.]

## SECOND ANSWER TO PETITION AS AMENDED

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, pursuant to leave heretofore granted, and for second answer to petition as amended and filed by the above-named petitioner, denies and alleges as follows:

4-G. Denies the allegations of error in subparagraph G of paragraph 4 of the Amendment to Petition.

5-Q. Denies the allegations in subparagraph Q of paragraph 5 of the Amendement to Petition.



7. Further answering the petition as amended, respondent alleges as follows:

(a) That petitioner omitted from gross income as reported on his income tax return for 1946 an amount properly includible therein, which is in excess of 25% of the amount of said gross income stated in said return.

(b) That on January 22, 1952, petitioner executed a Consent extending to June 30, 1953, the time within which income taxes for the year 1946 might be assessed.

(c) That if the earnings from the operation of the business known as "Mills Winery," for the period January 1, 1946, to August 6, 1946, in the amount of \$50,528.46 are held not taxable to petitioner, then, in the alternative, petitioner received a constructive dividend in the amount of \$27,500.00 by reason of the payment and satisfaction by "Mills Winery" of a debt owing by petitioner to John Azevedo.

Wherefore, it is prayed:

(1) That petitioner's appeal be denied and the Commissioner's determination in all respects be approved.

(2) That the Court determine that the assessment of deficiencies is not barred by the statute of limitations.

/s/ JOHN POTTS BARNES,

Chief Counsel,

Internal Revenue Service.

Filed September 6, 1955, T.C.U.S.

Served September 7, 1955.

The Tax Court of the United States

**Docket No. 49896**

ROBERT AZEVEDO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**Docket No. 49928**

IRENE KERSHAW,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**Docket No. 49929**

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

### STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto by their respective counsel, that the following facts shall be taken as true without prejudice to the right of either party to introduce

other and further evidence not inconsistent therewith.

1. Mills Winery, a California corporation, duly organized and existing under and by virtue of the laws of the State of California, incorporated March 4, 1946, located at Mills Station near the City of Sacramento, California, is engaged in the manufacturing and selling of wine and distilled fruit spirits.

2. Mr. John Azevedo, prior to 1945, was the owner of the real property and the improvements located thereon which were designed for the manufacturing of wine and spirits which was leased by the said John Azevedo to others in order to operate and maintain said winery.

On or about July, 1945, John Azevedo discontinued his lease arrangement with others and commenced operations as a sole proprietor doing business under the firm name and style of "Mills Winery." John Azevedo had issued to him in July, 1945, the necessary basic permits and licenses by the Federal Alcohol Tax Unit and the California State Board of Equalization. In July, 1945, John Azevedo negotiated for the purchase of grapes, for loans with the Capital National Bank of Sacramento for funds necessary for the purchase of grapes and crushing thereof. The preparations for the 1945 grape crush and the purchase of grapes thereof was the only activity of said John Azevedo.

At or about this time in July, 1945, the said John Azevedo employed Paul Kershaw, Jr., as a salesman

to sell wine after the same would have been manufactured and finished and employed Robert John Azevedo, his son, as the wine maker.

3. On or about August 1, 1945, John Azevedo agreed orally to sell the Winery to Robert J. Azevedo and Paul Kershaw, Jr., at "adjusted cost." The oral agreement was later reduced to written agreements dated December 1, 1945, which agreements are attached hereto and marked "Exhibit 1-A" and "2-B" respectively and incorporated herein by reference as if set forth in full herein.

4. Immediately thereafter and commencing August 1, 1945, the said Paul Kershaw, Jr., and Robert J. Azevedo, conducted the operations in connection with the crushing of grapes for the manufacturing of wine and carried out said operations to and including March 1, 1946, as copartners, at which time the said Robert J. Azevedo and Paul Kershaw, Jr., had prepared for filing with the Internal Revenue Department of the United States, a partnership Income Tax Return. That attached hereto and marked "Exhibit 3-C" is a photostatic copy of the United States Partnership Return of Income prepared for filing by Paul Kershaw, Jr., and Robert J. Azevedo with the United States Treasury Department for the period beginning August 1, 1945, and ending March 1, 1946.

5. That attached hereto and marked "Exhibit 4-D" and made a part hereof as if set forth in full herein is a photostatic copy of the Amended Cor-

poration Income Tax Return for the fiscal year beginning March 4, 1946, and ending March 3, 1947; that said Exhibit 4-D reflects that the inventory at the beginning of the corporate fiscal year, namely, March 4, 1946, amounted to \$445,467.09 which was the same amount that was reflected in the partnership return of income as the closing inventory of said copartnership on March 1, 1946, as is more specifically set forth in "Exhibit 3-C" hereinbefore referred to.

6. A financial statement prepared for the partnership on March 3, 1946, and prior to the date of the incorporation of Mills Winery, a California corporation, shows the following:

Paul Kershaw, Jr., and Robert Azevedo, DBA  
Mills Winery  
Route 2, Box 2851-B  
Sacramento, California

Financial Statement

March 3, 1946,

Assets

Inventory .....	\$445,467.09
Plant and Equipment .....	108,225.19
Land .....	5,000.00
Deferred Charges (Insurance).....	1,542.82
	<hr/>
	\$559,235.10



## Liabilities

Capital National Bank (OD.) .....	\$ 2,246.01
Accounts Payable .....	310,734.01
Accrued Taxes .....	55.08
Notes Payable .....	136,200.00
Reserve for Depreciation .....	None
Investment .....	110,000.00
	<hr/>
	\$559,235.10

Prepared without audit

Prepared by—National Accounting Service—  
Los Gatos

7. The adjusted cost of the Winery as of December, 1945, was approximately \$100,000.00 and the value of the inventory consisting of wine which was manufactured and came into being about March 1, 1946, was approximately equal to an indebtedness in the amount of \$440,000.00 representing money borrowed from the Capital National Bank, Sacramento, California, for the purpose of financing the 1945 crush.

No wine was sold and no amounts were paid on the indebtedness in 1945. John Azevedo was ultimately paid an extra \$10,000.00 over the agreed price of \$100,000.00, and the payments were made as follows:

March 22, 1946.....	\$ 5,000.00
April 17, 1946.....	10,000.00
June 24, 1946.....	45,000.00
July 4, 1946.....	50,000.00
	<hr/>
	\$110,000.00

The source of the payments to John Azevedo were from proceeds realized from the sale of wine after March 4, 1946, which was manufactured from the 1945 crush.

8. On May 1, 1946, Treasury Form 698 was executed on behalf of John Azevedo, doing business as "Mills Winery" and filed with the Federal Alcohol Tax Unit. In said Form 698 John Azevedo advised the Alcohol Tax Unit that he intended his basic permits to conduct a winery for the manufacture of wine and the distilling of fruit spirits to be discontinued as of the date similar basic permits and licenses were issued by Mills Winery, a California corporation.

On May 3, 1946, the corporation, Mills Winery, made application to the Federal authorities on Treasury Form 1634 to produce and blend wine and on Treasury Form 1639 to distill and sell distilled spirits. Attached to the application is a supplemental sworn statement as follows:

"Applicant's place of business will be purchased from John Azevedo, an individual and the present owner, when proper permits are received by applicant to engage in the operations of a Fruit Distillery. A Wine Producer's and Blender's Basic Permit, Form 1635, and a Distiller's Basic Permit, Form 1640, were issued by the Alcohol Tax Unit under date of August 13, 1946, effective 12:01 a.m. August 7, 1946."



9. The first meeting of the Board of Directors of the corporation was held on March 20, 1946, with all the directors being present. That attached hereto and marked "Exhibit E" is a photostatic copy of the Minutes of the First Meeting of the Board of Directors.

10. That on the 9th day of April, 1946, Paul Kershaw, Jr., on behalf of Mills Winery, a California corporation, executed a written agreement with certain other persons in connection with distilling Fruit Spirits; said spirits from fruits of all types to be distilled during the Fruit season of 1946, being the early Summer and late Summer of 1946. That attached hereto and marked "Exhibit 6-F" is a photostatic copy of that certain agreement entered into on the 9th day of April, 1946, by and between Mills Winery, a California corporation, and other persons, and the same is incorporated herein by reference as if set forth in full herein.

That after March 4, 1946, namely, on May 11, 1946, and on May 23, 1946, Mills Winery, a California corporation, entered into written agreements with the Southern Pacific Company wherein the Southern Pacific Company, as Licensor, and Mills Winery as Licensee, was granted by the said Southern Pacific Company to establish a private road crossing tracks at a grade and that the said agreements of May 11, 1946, and May 23, 1946, were attached to the Petitions heretofore filed by Robert J. Azevedo, Paul Kershaw, Jr., and Irene Kershaw before the Tax Court of the United States which

were described in said Petitions as "Exhibit D" and "Exhibit E," respectively; that reference is hereby made to said Exhibits D and E attached to said Petitions as if the same were set forth in full herein and made a part hereof.

11. By a Grant Deed dated June 21, 1946, John Azevedo and Frances Azevedo as Grantors granted to Mills Winery, a California corporation, all that certain real property upon which the wine premises and equipment are located. The deed was delivered by the Grantors to a Title Company in the County of Sacramento, State of California, for the benefit of the Grantee, namely, the California corporation, Mills Winery, but the escrow instructions filed by the Grantor with said Title Company contained no information regarding the delivery of the deed nor the length of time the deed was in escrow. The deed was recorded with the County Recorder of Sacramento County on November 23, 1946, in Volume 1294 at Page 351, of the official records of the County of Sacramento.

12. That from June, 1946, to and including the month of August, 1946, certain improvements, additions and alterations were being made by various General Contractors, Iron Workers, Designing Engineers and Plant Engineers relating to the Winery premises and the equipment located thereon which were all paid for by the corporation after the date of its incorporation; such payment being made from corporate funds arising out of proceeds resulting from the sale of wine from the 1945 crush.

13. At all times material herein there was a single bank account in the Capital National Bank of Sacramento, California, for the business operations of Mills Winery. During the period of August 1, 1945, to August 1, 1946, John Azevedo had the sole authority to sign checks and withdraw funds from the account.

On and after August 1, 1946, Robert J. Azevedo and Paul Kershaw, Jr., were granted permission to withdraw funds from said bank account on behalf of the corporation. All moneys withdrawn by John Azevedo from said bank account prior to March 4, 1946, were used to pay the obligations of Paul Kershaw, Jr., and Robert J. Azevedo as co-partners and all moneys withdrawn by John Azevedo after March 4, 1946, from said bank account and all expenditures that were made thereafter were made for the benefit of the corporation which came from the single bank account except the payments made to John Azevedo as described in Paragraph "7" of this Stipulation set forth above; that all bank loans, warehouse obligations and expenditures for improvements, alterations and additions made on the Winery premises and the equipment therein that were paid prior to August 1, 1946, were paid by checks drawn by John Azevedo from this single bank account and that all payments that were made after August 1, 1946, were paid by Paul Kershaw, Jr., from the same bank account.

14. On August 8, 1946, the corporation filed with the Collector of Internal Revenue, Form SS-4,

Application for Employer's Identification Number. The preceding identification number had been issued to John Azevedo, doing business under the name "Mills Winery."

15. Notifications of change in ownership of insurance policies and motor vehicles were made by the corporation during or, subsequent to August, 1946.

16. The third meeting of the Board of Directors of the corporation was held on August 12, 1946. A photostatic copy of the Minutes of this meeting marked "Exhibit G" is attached hereto and incorporated by reference herein.

17. In April, 1946, Mills Winery, a California corporation, employed A. H. Becker as the Managing Employee conducting the office affairs of said corporation. That as said employee the said A. H. Becker continuously, from April, 1946, to January, 1950, dealt with growers, wine manufacturers, distillers, fruit processors, wine brokers, and all persons interested in or connected with the fruit processing industry.

18. The corporation applied to the Corporation Commissioner of the State of California, on September 18, 1946, for permission to issue capital stock. The Corporation Commissioner granted permission on October 2, 1946, subject to the restriction that the stock be placed in escrow.

Thereafter, the corporation issued 10,000 shares of capital stock to Robert Azevedo and 10,000



shares to Paul Kershaw, Jr.; the stock, carrying a par value of \$100.00 per share was immediately placed in escrow with Robert C. Burnstein. The stock of the corporation is still in escrow.

19. On October 17, 1946, Robert J. Azevedo sold all of his stock to Paul Kershaw, Jr., for \$50,000.00.

20. During the period involved herein, 1945 and 1946, the only Basic Permits and Licenses from the Federal Alcohol Tax Unit and the California State Board of Equalization was issued to John Azevedo prior to August 7, 1946, and to the corporation thereafter.

21. The only wine sold was the wine inventory representing the 1945 crush and it was all sold during the period of March 4 to June 30, 1946. The sales were bulk sales in comparatively large quantity to consumers such as Italian Swiss Colony Wine Company, Petri Wine Company and Christian Brothers Wine Company. The invoices relating to the sales carried the name "Mills Winery."

22. The figures representing the selling price of the 1945 crush, and the expenses applicable thereto, were reported in the initial income tax return and the amended return Form 1120 filed by the corporation for the fiscal year beginning March 4, 1946, and ending March 3, 1947, as is set forth in "Exhibit 4-D" heretofore referred to.

23. That all sales of wine made during the period of March 4, 1946, to August 6, 1946, were picked up as corporate gross profit. All expenditures made

from and as of March 4, 1946, were paid as corporate expenditures and that the books from March 4, 1946, the date of incorporation of Mills Winery, a California corporation, to this date have been without interruption reporting all sales, expenditures and assets of the corporation, Mills Winery, a California corporation.

24. The Income Tax liability of Irene Kershaw, for the year 1946, is involved because of her community interest in the earnings of Paul Kershaw, Jr.

25. Photostatic copies of the 1946 Federal Income Tax Returns of Robert J. Azevedo, Paul Kershaw, Jr., and Irene Kershaw are attached hereto and incorporated by reference, being marked by "Exhibits H, I and 10-J," respectively.

/s/ JOHN POTTS BARNES,  
Attorney for Commissioner of  
Internal Revenue.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioners.

Dated: June 29, 1955.

Filed at hearing June 29, 1955.



## The Tax Court of the United States

ROBERT AZEVEDO, et al.,<sup>1</sup>

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos. 49896, 49928, 49929

Filed May 7, 1956.

Income—Taxable to Individuals or to a Corporation:

Petitioners, Robert Azevedo and Paul Kershaw, Jr., entered into an executory contract of sale with Robert's father, John, on December 1, 1945, under which John agreed to sell winery premises and inventory to them at such time as the petitioners should receive basic permits to make and sell wine and spirits, and further agreed that pending the receipt of the permits, the petitioners would be paid as salary in compensation for their services in operating and managing the winery, the earnings of the winery business. Petitioners managed and operated the winery, and the inventory of wine produced under their operations was sold before July 1, 1946, from which earnings were derived. Peitioners organ-

---

<sup>1</sup>Docket No. 49928, Irene Kershaw, and Docket No. 49929, Paul Kershaw, Jr., have been consolidated with Docket No. 49896.

ized a corporation in March, 1946, having the same name as the business which they managed. They contend that earnings from sales of wine are taxable to the corporation. Held, that the corporation did not own an inventory of wine prior to the sale thereof; that the proceeds from sales of the wine was not the corporation's income; and that the net earnings of the winery were compensation to petitioners under the agreement. Respondent's determinations sustained.

ROBERT C. BURNSTEIN, ESQ.,

For the Petitioners.

EDWARD H. BOYLE, JR., ESQ.,

For the Respondent.

## MEMORANDUM FINDINGS OF FACT AND OPINION

Harron, Judge:

The Commissioner determined deficiencies in income tax for the year 1946 as follows:

Docket No.	Taxpayer	Deficiency
49896	R. Azevedo	\$65,020.05
49928	I. Kershaw	27,108.10
49929	P. Kershaw	25,943.07

The chief question is whether net profit of \$202,-113.82 from sales of wine during the months March through June, 1946, is taxable in equal amounts to Robert Azevedo and Paul Kershaw, Jr., as the Commissioner has determined, or is taxable to a corporation.

### Findings of Fact

In 1946 Robert Azevedo resided in Santa Cruz, California, and he was unmarried. He filed an individual income tax return with the collector for the first district of California. In 1946 Paul and Irene Kershaw were husband and wife and they resided in Sacramento, California. They filed individual returns with the collector for the first district of California. Irene is involved in these proceedings only because she and her husband reported income for 1946 on a community property basis. Since the issues to be decided relate to Robert Azevedo and Paul Kershaw, they are referred to hereinafter as the petitioners.

John Azevedo is Robert's father. John is a construction contractor and he was engaged in the construction contracting business in 1945. John Azevedo, in 1945 and before, owned realty and 5 buildings thereon at Mills Station near Sacramento. This property is a winery known as Mills Winery. Before July, 1945, John leased the winery to Christian Brothers Winery, and John did not have the permits required to make wine. The adjusted basis of the property to John was \$100,000 in 1945. At about the end of June, 1945, the lease of the winery was terminated and in July, 1945, the necessary basic permits to make wine and distilled spirits were issued to John by the Federal Alcohol Tax Unit of the Bureau of Internal Revenue and the California State Board of Equalization. John then commenced operations as a sole proprietor doing business under the name of

Mills Winery. In July, John intended to operate the winery and he called in Paul Kershaw, a salesman, to take care of sales. Kershaw had been working in Oakland, California.

In the fall of 1945, John borrowed \$440,000 from the Capital National Bank of Sacramento for the purpose of buying grapes for the making of wine and he gave his note to the bank for the loan. Also, a checking account was established in Capital National Bank for the operation of Mills Winery. John Azevedo was the only person authorized to sign checks on and withdraw funds from this account during 1945 and until about August 1, 1946.

John's son, Robert, is a winemaker. Prior to the transactions involved here he graduated from the University of California, College of Agriculture.

In about August, 1945, John made an oral arrangement with Robert and Kershaw under which they were to engage in activities at the winery during the crush in the fall of 1945. Kershaw bought grapes for the fall 1945 crush. Robert performed the services of winemaker. John, although engaged in the contracting business, was present at the winery to supervise some construction work at the winery, and, also, he attended to financial transactions with Capital National Bank. The cost of the construction work at the winery was \$10,000.

By December 1, 1945, the fall crush was completed and an inventory of wine was in process of manufacture. There remained to be done the finishing

proceses of making the wine and the sale thereof. No wine was sold during 1945. All of the wine produced from the crush in the fall of 1945 was sold during four months in 1946, namely, during March, April, May, and June.

On or about December 1, 1945, after the fall crush but before the sale of any of the wine, the agreement set forth below was made by John Azevedo, the seller, with Robert and Kershaw, the purchasers, and was executed by each party. At the same time, Robert and Kershaw executed an agreement to protect John if there should be any judgments against him on account of any obligations he incurred from August 1, 1945, until the date of the actual transfer of the physical assets of Mills Winery to Robert and Kershaw, which date was stated to be the time that the latter received the Federal basic permits under which they could operate the winery. The agreements dated December 1, 1945, are as follows:

#### Agreement

This agreement, made this 1st day of December, 1945, by and between John Azevedo, Party of the first part, hereinafter called "Seller" and Robert Azevedo and Paul Kershaw, Jr., Parties of the Second Part, hereinafter called "Purchasers." Witnesseth:

Whereas, first party is desirous of selling to second parties that certain winery known as "Mills Winery" located at Mills Junction, California, and all the assets pertaining thereto; and,



Whereas, second parties are desirous of purchasing the same;

Now, therefore, in consideration of the mutual promises of the parties hereto, this agreement;

1. It is mutually understood and agreed by and between the parties that seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.

2. Purchasers agree to purchase said winery hereinbefore mentioned under the terms and conditions stated in paragraph 1, above.

3. It is mutually understood and agreed that seller shall remain the owner of said winery until such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same; provided, however, that purchasers shall, on January 1, 1946, operate and manage said winery for seller until said time as purchasers shall be able to make actual purchase of said winery, provided further that the compensation for said management, purchasers shall receive as salary the earnings of said business during said period of management.

4. It is further mutually agreed and understood by the parties hereto that unless the above-mentioned permits are issued in the names of purchasers



on or before January 1, 1947, this agreement shall at the option of seller be declared null and void.

5. It is hereby understood and agreed by the parties hereto that this agreement shall apply not only to the parties hereto but to their assigns.

In Witness Whereof, the parties hereto have hereunto set their hands the day and year first above written.

Signed—JOHN AZEVEDO,  
ROBERT AZEVEDO,  
PAUL KERSHAW, JR.

This agreement made and entered into this 1st day of December, 1945, by John Azevedo doing business as the Mills Winery and, Paul Kershaw, Jr., and Robert J. Azevedo.

Whereas for a consideration John Azevedo is selling the Mills Winery and all its assets to Paul Kershaw, Jr., and Robert J. Azevedo.

And, whereas as owner and operator of the Mills Winery, John Azevedo has contracted obligations since August 1st, 1945, Now as part of the consideration above referred to Paul Kershaw, Jr., and Robert J. Azevedo agree to assume and pay any judgment or judgments which may arise from Court action or otherwise against John Azevedo or the Mills Winery during 1945, and up to and including date of actual transfer of the physical assets of the Mills Winery which will be the time that the United States Government issues to Paul Kershaw, Jr., and

Robert J. Azevedo a basic permit to operate said Winery.

The Commissioner determined, and the petitioners concede, that the net profit derived from the sales of wine was \$202,113.82, which amount is computed as follows:

Gross sales .....	\$693,114.80
Cost of sales.....	445,467.09
Gross profit .....	247,647.71
Total expenses .....	45,533.89
<hr/>	
Net profit .....	\$202,113.82

Robert and Kershaw paid John \$110,000 in installments during March, April, June, and July. The payments were made out of the proceeds of the sales of wine which were made during the months March through June. The sum of \$110,000 represented John's adjusted basis of the Mills Winery property plus \$10,000 for improvements; it also was the consideration stated in the purchase and sale agreement dated December 1, 1945. The payments to John were made on the dates and in the amounts set forth below:

March 22, 1946.....	\$ 5,000
April 17, 1946.....	10,000
June 24, 1946.....	45,000
July 4, 1946.....	50,000
<hr/>	
	\$110,000

On July 4, 1946, when the payment of \$50,000 was made to John, he was still on the premises of the Mills Winery.

Capital National Bank was repaid the loan made to John, \$440,000, out of the proceeds from the sales of the 1945 crush which were made in the months March through June, 1946. The sales were bulk sales in large quantities to Italian Swiss Colony Wine Company, Petri Wine Company, and Christian Brothers Wine Company. The invoices for the sales bore the name, "Mills Winery."

On March 4, 1946, Kershaw and Robert caused to be filed with the Secretary of State of California articles of incorporation of a corporation named Mills Winery. In the articles of incorporation the directors named were Kershaw, Robert Azevedo, and James M. Popper. Mills Winery, a California corporation, was organized on March 4, 1946. Mills Winery, a California corporation, is referred to hereinafter as Mills Winery, Inc., or as the corporation.

The directors held their first meeting on March 20, 1946. At this meeting by-laws were adopted, Robert was elected president of the corporation, and Kershaw was elected vice-president, secretary, and treasurer.

A special meeting of the directors was held on August 12, 1946, at the Mills Winery, the office of the corporation. At this meeting resolutions were adopted authorizing the following: Authorization

was given for the issuance of 20,000 shares of capital stock of the par value of \$100 per share. Authorization was given for the issuance of 10,000 shares to Robert and 10,000 shares to Kershaw. The vice-president was authorized to file an application to the Corporation Commissioner of California for a permit authorizing the issuance of 20,000 shares, and the issuance of 10,000 shares, each, to Robert and Kershaw. Also, the following resolutions were adopted:

\* \* \*

Whereas, the consideration to be paid to this corporation by the above-named persons for the issuance of said stock shall be in cash and other considerations other than money,

Now therefore, Be It Resolved, that upon the issuance of a permit by the Corporation Commissioner, Department of Investment, for the issuance of such shares, that Robert J. Azevedo and Paul Kershaw, Jr., shall pay to this corporation for the obtaining of a deed for the real property upon which the business is to be operated by this corporation is located, the sum of \$55,000 each or a total of \$110,000 in cash, and that further Robert J. Azevedo and Paul Kershaw, Jr., shall, in addition to the aforementioned sum, pay to one John Azevedo, an individual, who previously operated Mills Winery as an individual, the sum of \$109,500 each or a total of \$219,000, which is the actual cost expended for the recent improvements and installations on the property in which the business of this corporation is to be located, which said improvements at the above cost

were expended on behalf of John Azevedo and that for the promotion and development of enterprises to be operated by this corporation as so developed and promoted by Robert J. Azevedo and Paul Kershaw, Jr., is reasonably equal to the sum of \$735,500 for each person above named.

It Is Further Resolved that with the cash payments as herein mentioned and the defraying of improvement and construction costs as herein mentioned and the services rendered, the value of which has been fixed by this corporation, each of the above-named persons shall have contributed the sum of \$1,000,000 to this corporation, which will entitle them to the delivery by this corporation when the same is authorized of 10,000 shares each of the capital stock of this corporation.

On September 18, 1946, application on behalf of Mills Winery, Inc., for permission to issue 20,000 shares of capital stock, 10,000 shares, each, to Robert and to Kershaw, was filed with the California Corporation Commissioner. In this application, request was made to issue 13,500 shares (part of the 20,000 shares) in "promotional stock" (the value of which was fixed at some undisclosed sum in minutes of the corporation), by reason of the promotional services rendered by Robert and Kershaw, of which one-half, or 6,750 shares, each, were to be issued to Robert and Kershaw (part of the 10,000 shares to be issued to each) for their respective promotioal services. Such promotional stock, having a par value of \$1,350,000,



if authorized and issued, was to represent paid-in capital of the corporation.

On May 1, 1946, Treasury Form 698 had been executed on behalf of John Azevedo, doing business as "Mills Winery," and filed with the Federal Alcohol Tax Unit. In the Form 698, John Azevedo advised the Alcohol Tax Unit that he intended his basic permits to conduct a winery for the manufacture of wine and the distilling of fruit spirits to be discontinued as of the date similar basic permits and licenses were issued to Mills Winery, a California corporation.

On May 3, 1946, the corporation, Mills Winery, Inc., made application to the Federal authorities on Treasury Forms 1634 and 1639 for basic permits to produce and blend wine and to distill and sell distilled spirits. Attached to the applications was the following sworn statement:

Applicant's place of business will be purchased from John Azevedo, an individual and the present owner, when proper permits are received by applicant to engage in the operations of a Fruit Distillery.

A wine producer's and blender's basic permit, Form 1635, and a distiller's basic permit, Form 1640, were issued by the Alcohol Tax Unit of the Bureau of Internal Revenue under date of August 13, 1946, effective August 7, 1946. On about August 12, 1946, but before that date, the California State Board of Equalization issued to Mills Winery, Inc., a wine



manufacturers' license and a distilled spirits manufacturers' license. As of August 12, 1946, or a few days before, the corporation therefore had the basic Federal and state permits to engage in the business of manufacturing and selling wine and distilled spirits.

By a grant deed dated June 21, 1946, John Azevedo and Frances Azevedo, as grantors, granted to Mills Winery, a California corporation, all the real property upon which the Mills Winery premises and equipment were located. The deed was delivered by the grantors to a title company in the County of Sacramento, State of California, to be held in escrow for the benefit of the grantee, namely, Mills Winery, Inc. The escrow instructions filed by the grantor with the title company do not contain information regarding the delivery of the deed, nor the length of time the deed was to be held in escrow. The record in these cases does not establish how long the deed was held in escrow or the date when it was delivered to Mills Winery, Inc. The deed was recorded with the Recorder of Sacramento County on November 23, 1946, in volume 1294, at page 351, of his official records.

With respect to the issuance of the capital stock of Mills Winery, Inc.: On October 2, 1946, the California Corporation Commissioner granted permission to the corporation to issue 20,000 shares of capital stock (including the 13,500 shares of promotional stock), 10,000 shares, each, to be issued to Robert Azevedo and to Paul Kershaw, subject to the restric-

tion that the stock be placed in escrow. Thereafter, the corporation issued 10,000 shares of its capital stock, each, in the names of Robert and Kershaw but the stock was immediately placed in escrow with an attorney, Robert C. Burnstein. At the time of the trial of these cases, all of the stock was still held by Burnstein in escrow. The holding of the stock in escrow was in accordance with certain requirements of the laws of California relating to corporations and the issuance of corporation stock.

After the organization of Mills Winery, Inc., on March 4, 1946, various activities were carried on by Robert and Kershaw as officers and directors of Mills Winery, Inc., among which were the following:

On April 9, 1946, Kershaw, on behalf of the corporation entered into an agreement with certain individuals under which the corporation agreed to make distilled fruit spirits during the 1946 fruit season from fruit juice and pulp to be furnished by the individuals and to pay the individuals a part of the proceeds from the sale of the distilled fruit spirits. On April 9, 1946, the corporation did not have title to the winery property and equipment.

In April, 1946, Mills Winery, Inc., employed A. H. Becker as the managing employee to conduct the office affairs of the corporation. As such employee, Becker continuously, from April, 1946, to January, 1950, dealt with growers, wine manufacturers, distillers, fruit processors, wine brokers, and all persons interested in or connected with the fruit processing industry.

On May 11, 1946, and on May 23, 1946, Robert, as president of the corporation, entered into written agreements with Southern Pacific Company, a railroad company, whereby Southern Pacific, as licensor, granted Mills Winery, Inc., rights to private road crossings over tracks of Southern Pacific, "at grade," at certain locations. On May 11 and May 23, 1946, the corporation did not have title to the realty where the winery was located or where the rights of way covered by the agreements with Southern Pacific were located.

From June, 1946, to and including the month of August, 1946, certain improvements, additions and alterations, were being made by various general contractors, iron workers, designing engineers, and plant engineers relating to the winery premises and the equipment located thereon, all of which were paid for by the corporation after the date of its incorporation, such payment being made from funds arising out of proceeds from sales of wine made from the 1945 crush.

On August 8, 1946, the corporation filed with the collector of internal revenue, Form SS-4, Application for Employer's Identification Number. The preceding identification number had been issued to John Azevedo, doing business under the name, "Mills Winery."

Notifications of change in ownership of insurance policies and motor vehicles were made by the corporation during or subsequent to August, 1946.

At all times material, there was a single checking account in the Capital National Bank of Sacramento, California, for the business operations of the business carried on under the name of Mills Winery. During the period of August 1, 1945, to August 1, 1946, John Azevedo had the sole authority to sign checks and withdraw funds from this account. On and after August 1, 1946, Robert Azevedo and Paul Kershaw were granted permission to withdraw funds from the bank account on behalf of the corporation. All bank loans, warehouse obligations, and expenditures for improvements, alterations and additions made on the winery premises and on the equipment therein, that were paid prior to August 1, 1946, were paid by checks drawn by John Azevedo on the single bank account. All payments that were made after August 1, 1946, were paid by checks drawn by Kershaw on the same bank account.

The records of the Commissioner of Internal Revenue do not show that a partnership return of income, Form 1065, was filed by a partnership doing business under the name of Mills Winery for any period or for the period August 1, 1945, to March 1, 1946. In the individual income tax returns for 1946 of Robert, Paul Kershaw, and Irene Kershaw, no income was reported from the sales of wine made from the 1945 crush, which net income is involved in these cases, and no income was reported as the distributive share, respectively, of Robert and of Paul Kershaw of the earnings of a partnership named Mills Winery. The individual income tax return of



Paul Kershaw for 1946 reports receipt of salary from Mills Winery, Inc., in the amount of \$10,000. The individual return of Robert for 1946 does not report the receipt of any salary payments by the corporation.

A corporation income tax return, Form 1120, was filed for Mills Winery, Inc., for the taxable period beginning March 4, 1946. The return was prepared by National Accounting Service of Los Gatos, California. In this corporation income tax return, net income was reported in the amount of \$225,805.61. The return was signed by Kershaw as an officer of the corporation on May 7, 1947, and it was filed on May 15, 1947. In the return earned surplus and undivided profits were stated to be \$225,805.61, and the only officer reported as receiving compensation was Kershaw for whose salary a deduction of \$10,000 was taken. Also, in this corporation return inventory at the beginning of the taxable period was stated to be \$445,467.09.

An amended corporation return for the same fiscal period as the original return was executed on May 26, 1947, by Paul Kershaw. In this return net income was reported in the amount of \$203,432.29, earned surplus and undivided profits was reported in the amount of \$203,432.29, and a deduction of \$30,000 was taken for Kershaw's salary. Opening inventory was stated to be \$445,467.09 at March 4, 1946.

The figures representing the selling prices of the wine made from the 1945 crush and the expenses ap-

plicable thereto were included in the income and expenses which were set forth in the original return and in the amended return filed for the Mills Winery corporation for the fiscal period March 4, 1946, to March 3, 1947. The profits from the sales of wine made from the 1945 crush were "picked up" as profit of the corporation in its returns for the above period.

A corporation income tax return for the fiscal period March 1, 1951, to February 29, 1952, was filed for Mills Winery, Inc., the corporation. The balance sheet in the return, Form 1120, reported no outstanding capital stock at the beginning of the taxable period. The balance sheets in the corporation returns for the fiscal period March 4, 1946 to March 3, 1947, did not report any outstanding capital stock.

In the minutes of the special meeting of the directors of Mills Winery, Inc., on August 12, 1946, a resolution was adopted which provided, inter alia, that Robert and Kershaw were to pay to the corporation in cash \$55,000, each, or \$110,000 for the purpose of obtaining the deed from John and Frances Azevedo to the real property where the Mills Winery is located. The sum of \$110,000 was never paid to the corporation by Robert and Kershaw. A liability of \$110,000 owed by Robert and Kershaw was first reflected in the balance sheet in the corporation income tax return filed for the period March 1, 1951, to February 29, 1952, as an item of capital stock.

Mills Winery, Inc., is still in existence.



On October 17, 1946, Robert Azevedo sold all of his stock in Mills Winery, Inc., to Paul Kershaw, Jr., for \$50,000.

On February 26, 1952, Robert Azevedo executed and filed a consent extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed.

On January 22, 1952, Paul Kershaw, Jr., executed and filed a consent extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed.

On January 22, 1952, Irene Kershaw executed and filed a consent extending to June 30, 1953, the time within which the income tax for the year 1946 might be assessed.

The individual returns for 1946 of Robert Azevedo, Paul Kershaw, Jr., and Irene Kershaw were filed on March 7, 1947, March 15, 1947, and March 20, 1947, respectively.

The notices of deficiencies which have given rise to these cases were mailed by the Commissioner on May 13, 1953.

Title to the real property of the winery and to the improvements did not pass from John and Frances Azevedo to Mills Winery Corporation until sometime after August 12, 1946. John did not sell the wine inventory from the 1945 crush to Robert and Kershaw or to the corporation before the wine was sold.

Robert Azevedo and Paul Kershaw, Jr., in the agreement of December 1, 1945, agreed to buy the winery property and real estate as individuals. Under the agreement of December 1, 1945, it was agreed that on and after January 1, 1946, Robert and Kershaw would operate and manage the winery for John Azevedo until such time as they, the purchasers, should be able to make the actual purchase of the winery, and that Robert and Kershaw should receive as their salaries and compensation for their services the earnings of the winery business during the period of their management.

During the period January 1, 1946, to August 6, 1946, the net earnings of the winery business known as Mills Winery amounted to \$202,113.82, and these earnings were derived from the sales in the months March through June, 1946, of the wine made from the 1945 crush. These earnings represented, 50 per cent to each, or \$101,056.91 to each, compensation and salary to Robert Azevedo and Paul Kershaw, Jr., respectively, for his services in the operation and management of the business known as Mills Winery, and for their respective services in the making and selling of wine from the 1945 crush during the period January 1, to August 6, 1946; these net earnings were not the earnings of the corporation, Mills Winery, Inc.

---

Each petitioner omitted from the gross income reported in his and her individual return for 1946, an amount properly includible therein which is in ex-

cess of 25 per cent of the amount of gross income stated in the individual return.

The Commissioner determined that the earnings from the operation of the business known as Mills Winery for the period from January 1, to August 6, 1946, were taxable to Robert Azevedo and Paul Kershaw, Jr. He determined that the net profit from the operation of the Mills Winery business during the above-stated period amounted to \$202,113.82 and that 50 per cent thereof was taxable to Robert and to Paul in the amount of \$101,056.91, each. The Commissioner also determined that Robert was entitled to deduction for a short-term capital loss on the sale of 10,000 shares of capital stock of Mills Winery, Inc.

The Commissioner's determination of the amount of the net profit from the operation of the Mills Winery business for the above-stated period, as set forth in the statement attached to the notices of deficiency is as follows:

### Statement of Income

#### Mills Winery

Jan. 1, 1946 through Aug. 6, 1946

Sales .....	\$693,114.80
Cost of Sales.....	445,467.09
	<hr/>
Gross Profit .....	\$247,647.71
Total Expenses .....	45,533.89
	<hr/>
Net Profit .....	\$202,113.82

## Distributable

Robert Azevedo .....	\$101,056.91
Paul Kershaw, Jr.....	101,056.91
	<hr/>
	\$202,113.82

In determining the amount of the short-term capital loss on the sale of 10,000 shares of capital stock of Mills Winery, Inc., in the case of Robert Azevedo, the Commissioner computed the amount of the loss in the following way:

Cost basis of 10,000 shares of Mills

Winery, Inc., capital stock acquired

by you on August 6, 1946.....\$101,056.91

Selling Price of stock on October 5, 1946    50,000.00

Short-term capital loss on sale.....\$ 51,056.91

Allowable deduction for capital loss

(limited to \$1,000 under provisions

of section 117(d)(2) of the Internal

Revenue Code) ..... 1,000.00

Capital loss on sale of stock claimed

on your return..... None

Decrease in gross income.....\$ 1,000.00

The facts which have been stipulated which are not set forth above are found in accordance with the stipulation.

## Opinion

The chief question is whether the net income from sales of wine which were made during the months March through June, 1946, the wine having been made from the 1945 crush, is taxable to Robert Azevedo and Paul Kershaw, Jr., as the Commissioner has determined, or whether the income is taxable to the corporation, Mills Winery, Inc. If it is determined that one-half of the income in question, \$202,-113.82, is the income of Robert and Kershaw in equal amounts, it follows that each of the petitioners, Robert, Kershaw, and Irene, omitted from the gross income which each reported in his and her return an amount properly includible therein which is in excess of 25 per cent of the amount of gross income stated in the return, and therefore the provisions of section 275(c), 1939 Code, apply and the deficiencies are not barred.

The evidence in this proceeding consists of a stipulation of facts, exhibits, and the testimony of Kershaw and Burnstein. Neither John nor Robert Azevedo testified or appeared during the trial of these cases. All of the evidence has been considered carefully, as well as the arguments of counsel for the parties. The facts which have been stipulated largely are facts which are involved in the theory of the petitioners. The respondent relies chiefly upon the agreement of December 1, 1945, between John, who is designated the seller, and Robert and Kershaw who are designated the purchasers. The respondent, too, relies upon the facts relating to the various steps



which were taken in organizing the Mills Winery corporation and particularly upon the dates on which the various steps were taken.

Petitioners contend that from about August 1, 1945, until about March 1, 1946, Robert and Kershaw were copartners, doing business under the name of Mills Winery, and that the activities of the copartners consisted in the purchase of grapes in the fall of 1945 and the making of wine from the crush in preparation for the sale of the wine in bulk on the open market in 1946; that on March 4, 1946, the corporation, Mills Winery, Inc., was organized and purchased from Robert and Kershaw the net worth of the partnership, acquired the partnership assets and assumed partnership liabilities; that the partnership assets consisted primarily of a wine inventory and that the liabilities were primarily those that arose from bank loans obtained to finance the 1945 crush together with the cost of several improvements to the winery which were made during the 1945 crush plus an obligation of \$100,000 to John Azevedo. The petitioners contend further that immediately after its incorporation, the corporation commenced corporate business activities and that Kershaw, as an officer of the corporation, sold the wine from the 1945 crush on behalf of the corporation, and therefore that the income realized from the sale of the wine was the income of the corporation rather than the income of Robert and Kershaw. The petitioners contend also that the deficiencies are barred. The corporation received from the Alcohol



Tax Unit of the Bureau of Internal Revenue the basic permits to produce wine and distill spirits, effective August 7, 1946. This date provides the explanation for the Commissioner's determination in the deficiency notices that August 6, 1946, is the end of a taxable period during which Robert and Kershaw earned income in the amount of \$202,113.82. The parties used the date, August 6, 1946, as a critical date and petitioners' argument relates, in part, to the period March 4, 1946, to and including August 6, 1946. The petitioners take the view that the corporation acquired an inventory of wine on March 4, 1946. Since the sales of the wine which is involved under this issue were made during the 4-month period, March through June, 1946, the petitioners contend that the sales were made by the corporation.

Upon thorough consideration of the arguments of petitioners' counsel and of the entire record, the contentions of the petitioners are found to be strained and seriously impaired by the absence of evidence to establish that what the petitioners argue took place actually occurred. Moreover, there have been established several facts relating to the organization of the corporation which militate against the contentions of the petitioners. The facts and circumstances which are adverse to the petitioners are set forth hereinafter. The entire record supports the determinations of the Commissioner and it is concluded that the total net income derived from the sales during the months of March through June, 1946, of the wine made from the 1945 crush was the income of

Robert and Kershaw in equal amounts of \$101,-056.91. This conclusion must be reached because of the facts relating to what was done. The theory of the petitioners is founded, largely, upon what might have been but was not done, as well as upon facts relating to a business which eventually was carried on by the corporation which had nothing to do with the sales of the wine which is involved.

The issue to be decided involves basically the principle that earned income is taxable to the person who earns it, and income produced by property is taxable to the person who owns the property at the time the income is produced. *Lucas v. Earl*, 281 U. S. 111. A tax cannot be escaped "by anticipatory arrangements and contracts however skillfully devised." It is true that a distinction is made between a gift or transfer of earnings by the person who has earned income or otherwise created the right to receive it and enjoy the benefit of it when it is paid, *Corliss v. Bowers*, 281 U.S. 376; *Helvering v. Horst*, 311 U.S. 112; *Helvering v. Eubank*, 311, U.S. 122, and income produced by property after the ownership thereof has been conveyed to another, *Blair v. Commissioner*, 300 U.S. 5. In these cases the above distinction has been taken into account and the facts have been scrutinized to determine whether the rule of *Lucas v. Earl*, *supra*, applies rather than the rule of *Blair v. Commissioner*, *supra*. Our conclusion is that the facts bring these cases under the rule of *Lucas v. Earl*, *supra*. Stated simply, the situation was as follows: John, the father of Robert, was en-

gaged in the construction business before and during 1945 and thereafter. He owned the Mills Winery property but he had leased it to a wine producer, Christian Brothers Winery, and he did not have the Federal and state basic permits to make wine and distilled spirits. His son, Robert, had become a winemaker by training and it appears that John was ready to set his son up in business but Robert had no capital. Under these circumstances John was willing to assist Robert and Kershaw to the extent of having them take over the operations and management of the Mills Winery, borrow the required capital to purchase grapes and finance the first crush, and allow Robert and Kershaw as their compensation for their personal services the entire net earnings of the Mills Winery during the period of their management. John was willing to sell the winery property and improvements to Robert and Kershaw for the adjusted basis to John which was, at the end of 1945, \$100,000. It was not inconceivable that the gross proceeds from the sale of the wine made from the 1945 crush would be large enough to repay the bank loans, the amount of which entered into the cost of the wine, and to yield net earnings of \$100,000 or more. Kershaw was a salesman and Robert was a winemaker. There was no written partnership agreement between Robert and Kershaw. Under the written agreement of December 1, 1945, with John, however, they were to operate the winery for John in consideration of the receipt of salary and compensation for their services.

The written agreement of December 1, 1945, is controlling. The agreement is clear and unambiguous. The agreement is a purchase and sale agreement in which John is the seller and Robert and Kershaw are the purchasers. The agreement provides that the purchasers shall operate and manage the winery beginning on January 1, 1946, until such time as the purchasers shall be permitted to receive in their name the basic permits which would enable them to operate the winery, i.e., manufacture wine and distilled spirits under Federal and state regulations. The agreement provided that until such time as the purchasers should be able to make the actual purchase of the winery, they should receive compensation for their services to consist of the earnings of the business during the period of their management. The agreement of December 1, 1945, with respect to the sale of the winery premises was an executory contract. The Federal and state basic permits to make wine and distilled spirits were not issued until August, 1946. Until that time the condition precedent upon which the actual sale and purchase of the winery depended did not come into existence. Although Robert and Kershaw caused a corporation to be organized on March 4, 1946, there was no written assignment by Robert and Kershaw of their interests in the agreement of December 1, 1945, to the corporation and there was no written evidence of assumption by the corporation of any of the obligations of Robert and Kershaw as purchasers of the real estate and improvements making up the winery premises under the written agreement of December



1, 1945. All that we have is the self-serving testimony of Kershaw that the corporation took over what is referred to as the winery business and the inventory of wine. The assertion of Kershaw that the sales of wine in the months March through June, 1946, were made on behalf of the corporation is not supported by any independent proof that this was a fact. For example, books and records of the corporation were not introduced in evidence. There was no bill of sale from either Mills Winery, the sole proprietorship, or from John Azevedo to the corporation of the inventory of the wine made from the 1945 crush. There was no sale of the wine inventory to Robert and Kershaw before the wine was sold and they could not convey the wine inventory to the corporation. Issuance of stock of the corporation was not authorized and issued until October 2, 1946, which was after the wine which is in question had been sold. The mere statement in the corporation income tax return for the period March 4, 1946, to March 3, 1947, which was prepared for the corporation that the corporation had an inventory in the amount of \$445,467.09 on March 4, 1946, is not competent proof that the corporation in fact acquired and owned the inventory of wine which was sold during March through June, 1946, from which sales the income in question was derived. Such statement in the original and amended corporation returns is self-serving.

The agreement of December 1, 1945, did not provide for the sale to Robert and Kershaw of an inventory of wine; the agreement related only to the

sale of the winery real estate and improvements. This conclusion is reached from consideration of all of the provisions of the agreement. It is noted that the agreement stated in paragraph 1 that "seller will sell to purchasers that certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price." But the sale agreement was an executory agreement, the seller to remain the owner of the winery, assets and inventory "until such time as the purchasers shall be permitted to receive in their name certain basic permits which will enable them to purchase and own said winery and operate the same \* \* \*." Furthermore, it was mutually agreed and understood by the parties "that unless the above-mentioned permits are issued in the names of purchasers on or before January 1, 1947, this agreement shall at the option of seller be declared null and void." It can only be concluded that under the terms of the agreement ownership of the inventory of wine produced from the 1945 crush remained in John Azevedo during the months when the wine was sold, and since all the wine was sold before the Federal and state basic permits were issued to Robert and Kershaw, or to the corporation, it cannot be concluded that Robert and Kershaw owned the inventory of wine which they contend they conveyed to the corporation as of March 4, 1946. It is held that the corporation did not own the inventory of wine which was sold in March through June, 1946. It is held, further, that the in-



ventory of wine which was sold was owned by John Azevedo when the sales were made.

Under the above holdings, the position of the petitioners amounts to an effort to have the earnings produced by the sales of the wine taxed to the corporation. Such condition cannot be sustained under the rule of *Lucas v. Earl*, *supra*; *Helvering v. Horst*, *supra*; and *Helvering v. Eubank*, *supra*. The corporation did not own the property—the wine—before the income derived from the sales thereof came into being. The rule of the *Blair* case does not apply.

The inventory of wine, which was owned by John Azevedo, was sold and the bank loans which he had obtained were repaid out of the proceeds of the sales; other expenses were paid out of the proceeds of the sale; and under the provisions of paragraph 3 of the agreement of December 1, 1945, Robert and Kershaw had the right to the net proceeds of the sales as their salaries for their personal services in managing and operating the sole proprietorship business of John Azevedo and in making and selling the wine produced during the period of management by Robert and Kershaw. It is presumed that Robert and Kershaw received, one-half each, the net proceeds from the operation of the winery business, in the total amount of \$202,113.82. Petitioners have not shown that they did not receive the income or that they did not have dominion and control over the income. There is no proof that all or part of the net earnings of the winery derived from the sales of the inventory of wine during March through June, 1946,

came into the possession of the corporation. For example, there was no bank account opened in the name of the corporation as of March 4, 1946. Furthermore, the authority to draw checks on the bank account of the winery business remained exclusively in John until August, 1946, and until then petitioners had no authorization to make withdrawals from the account. We do not have in evidence any checks of buyers of the wine in question made payable to the corporation. But even if the net proceeds from the sale of the wine had been paid to and come into the possession of the corporation, that would amount to no more than an anticipatory arrangement whereby the income in question, earned by Robert and Kershaw, was received by the corporation rather than by the individuals who earned the income, and such arrangement would not serve to relieve Robert and Kershaw from tax on the income.

There are facts in the Findings which relate to the operations of the corporation. At the time of the trial of these cases the corporation was still in existence and it apparently has carried on a business of its own. But these facts are immaterial in deciding the question before us.

It is unnecessary to point out other factors which are adverse to the petitioners because they are only cumulative.

The Commissioner's determinations are sustained.

It is unnecessary to consider an alternative contention of the Commissioner in view of the conclusions reached above.

Petitioners contend that the Commissioner had the burden of proof under the chief issue and they cite *Jacobs v. United States*, 126 F. Supp. 154. This contention of the petitioners is based upon the fact that the deficiencies were not determined within the normal 3-year period of limitations and the Commissioner is relying upon the 5-year period provided by section 275(c). We are satisfied that the respondent has met his burden of proof. Cf. *Leslie H. Green*, 7 T.C. 263, 277, *affd.* 168 F. 2d 994.

The petitioners contend that the deficiencies are barred because the agreements extending the period for assessment were executed more than 3 years after the filing of the income tax returns. The income tax returns of the petitioners were filed on March 7 and March 15, respectively, of 1947. The agreements extending the period for assessment to June 30, 1953, were executed, respectively, on January 22, 1952, and February 26, 1952. These dates were within 5 years from the dates of the filing of the income tax returns of the petitioners. The same question was presented in *May D. Hatch*, 14 T.C. 237, 243, *et. seq.*, reversed on another ground, 190 F. 2d 254. This Court held that since the taxpayer had omitted from gross income an amount which was in excess of 25 per cent of the gross income stated in the return for the taxable year, a period of 5 years from the date the return was filed was allowed for making assessment of the tax, and that since the agreements extending the period for assessment had been executed prior to the expiration of the 5-year period,

and since the deficiency notice was mailed to the taxpayer before the expiration of the extended period, the deficiency notice was timely and the period for assessment of the taxpayer's income tax liability had not expired. The question is controlled by *May D. Hatch*, *supra*. It is held that the deficiencies are not barred.

Decisions will be entered for the respondent.

Received April 27, 1956.

Entered May 7, 1956.

Served May 7, 1956.

---

The Tax Court of the United States  
Washington

Docket No. 49896

ROBERT AZEVEDO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed May 7, 1956, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1946 in the amount of \$65,020.05.

/s/ MARION J. HARRON,  
Judge.

Entered May 7, 1956.

Served May 7, 1956.

---

The Tax Court of the United States  
Washington

Docket No. 49928

IRENE KERSHAW,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed May 7, 1956, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1946 in the amount of \$27,108.10.

/s/ MARION J. HARRON,  
Judge.

Entered May 7, 1956.

Served May 7, 1956.

The Tax Court of the United States  
Washington

Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Findings of Fact and Opinion, filed May 7, 1956, it is

Ordered and Decided: That there is a deficiency in income tax for the year 1946 in the amount of \$25,943.07.

/s/ MARION J. HARRON,  
Judge.

Entered May 7, 1956.

Served May 7, 1956.



The Tax Court of the United States

Tax Court Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF  
TAX COURT DECISION

Taxpayer, the Petitioner in this cause by Robert C. Burnstein, Counsel, hereby files his Petition for Review by the U. S. Court of Appeals for the Ninth Circuit of the decision by the Tax Court of the United States rendered on May 7, 1956 (T. C. Memo 1956-109) No. 49929, determining deficiency in the Petitioner's Federal Income Taxes for the Calendar Year 1946, in the amount of \$25,943.07, and respectfully shows:

I.

The Petitioner in 1946, resided in Sacramento, California, and was married to Irene Kershaw. He filed an individual Income Tax Return with the Collector of the First District of California.

II.

**Nature of Controversy**—The controversies involves the determination as to whether or not net profits from the sales of wine during the months of March through June, 1946, is taxable in equal

amounts to the Petitioner herein and Robert Azevedo, or is taxable to a California Corporation, namely, Mills Winery, which was organized under and by virtue of the laws of the State of California, on March 4, 1946.

John Azevedo, the father of Robert Azevedo, prior to 1945, was the owner of certain real property and improvements upon which a winery was located and which had been leased by John Azevedo to persons other than the Taxpayer herein to operate and maintain said winery.

In July, 1945, the said John Azevedo discontinued his lease arrangement with others, commenced as a sole proprietor the operation of the winery on the land owned by him and did business under the firm name and style of "Mills Winery." He held all the necessary basic permits to engage in the business as a winery and distillery required by the various governmental authorities.

On or about the 1st day of August, 1945, John Azevedo agreed to sell the winery to the Petitioner herein and Robert Azevedo at an adjusted cost which oral agreement was later reduced to written agreements dated December 1, 1945.

Commencing August 1, 1945, Petitioner herein and Robert Azevedo conducted operations at Mills Winery in connection with the crushing of grapes for the manufacturing of wine and did the same as copartners. The copartnership borrowed money from the Capital National Bank at Sacramento, said loan

being arranged through the efforts of John Azevedo. The total capital necessary for the formation of the copartnership for the purchase of the grapes and the manufacturing of the wine was obtained from said Bank by way of a loan. The inventory, namely, the wine that came into existence from the 1945 grape crush was an inventory owned by the Petitioner and Robert Azevedo as a partnership asset and such inventory came into existence as a result of the partnership efforts of the partners buying grapes and making wine. The partnership completed the crush in December of 1945, finished the wine and proceeded to seek markets for the same in January and February of 1946.

The copartners then decided to change the organization under which they would be selling said wine in bulk to various other wineries and did on March 4, 1946, organize a California corporation, namely, Mills Winery. At the close of the partnership and the dissolution thereof, the partnership books and records were closed, a final partnership income tax return prepared and all of the assets and liabilities of the copartnership which included the wine inventory was sold, transferred and assigned by the copartnership to the corporation. During all this time, namely, from August 1, 1945, to August 6, 1946, the basic permits and other governmental permits and licenses required to engage in business as a distillery and/or a wine manufacturer, stood in the name of John Azevedo, the father of Robert Azevedo.

Application for the necessary permits had been made in the month of May, 1946, by Mills Winery, a California Corporation. At no time however did the corporation engage in the manufacturing of wine or distilling of spirits but merely proceeded to sell bulk wine which it acquired at a single instance on a single purchase from the copartners upon the dissolution of the partnership and the organization of the corporation by said copartners.

That during the operation of the copartnership from August 1, 1946, to March 4, 1946, and after March 4, 1946, to and including August 1, 1946, there was just one single bank account which was a commercial account at the Capital National Bank in Sacramento and this account was used for the business operations of the copartnership during its existence and for the corporation from March 4, 1946, to August 1, 1946.

That at all times from August 1, 1945, to August 1, 1946, John Azevedo, the father of Robert Azevedo, had the sole authority to sign checks and withdraw funds from the account but that all monies that were withdrawn prior to March 4, 1946 from said account were used to pay the obligations of Petitioner and Robert Azevedo as copartners and all monies withdrawn from said account after March 4, 1946, were used to pay the obligations of the corporation.

That after August 1, 1946, the same bank account continued but with the Petitioner and Robert Azevedo being authorized to sign checks thereon. All of the sales of the wine were made after March 4, 1946,

and were completed before July 1, 1946. All such sales were recorded as corporate gross profit in the books and records of the corporation and all obligations incurred after March 4, 1946, were recorded as corporate expenditures and were paid as corporate expenditures and appeared on the books and records of the corporation.

The corporation filed its Income Tax Return based upon the profit made from the sales of said wine during said period and paid its tax thereon.

During this period of time, namely, from and after March 4, 1946, to August 6, 1946, other corporate activities were carried on by the corporation through its officers and employees indicating corporate activity.

The Petitioner filed his 1946 U. S. Individual Income Tax Return on March 15, 1947, and he executed a consent fixing the period of limitation upon assessment of income tax on January 22, 1952. The Notice of Deficiency was mailed to Petitioner on May 13, 1953.

The Commissioner of Internal Revenue held that the corporation did not own an inventory of wine prior to the sale thereof and that proceeds from the sales of the wine was not corporation income but was earnings to the Petitioner and Robert Azevedo by reason of the terms of certain agreements dated December 1, 1945, this determination all contrary to the conduct and intent of the parties as expressed by their actions and conduct.



III.

The said Taxpayers being aggrieved by the Findings of Fact and Conclusions of Law contained in said Findings and opinion of the Court and by its Decision entered pursuant thereto desires to obtain a review thereof by the U. S. Circuit Court of Appeals for the Ninth Circuit.

/s/ ROBERT C. BURNSTEIN,  
Counsel for Petitioner.

Received and Filed June 25, 1956, T.C.U.S.

---

Popper and Burnstein  
Attorneys at Law  
414 13th Street  
Oakland 12, California  
Telephone TEmplebar 6-4400

August 1, 1956.

Clerk, U. S. Tax Court,  
Washington 4, D. C.

Re: Paul Kershaw, Jr., Docket No. 49929  
Irene Kershaw, Docket No. 49928

Dear Sir:

Upon my return to my office after being away for approximately thirty days, I had an opportunity to re-examine the Petitions for Review that have been filed and served in the above-entitled matters.

I noted that in the matter of Irene Kershaw, Docket No. 49928, on Page "4" that there was a typographical error which I believe should be cor-

rected although the error when reading the entire Petition is obvious. On Page "4" there is contained in said Petition the following paragraph:

"That during the operation of the copartnership from August 1, 1946, to March 4, 1946, and after March 4, 1946, to and including August 1, 1946, there was just one bank account, etc."

This paragraph is in error as it refers to one date. The paragraph should read:

"That during the operation of the copartnership from August 1, 1945, to March 4, 1946 \* \* \*"

The error was obviously August 1, 1945, in place of August 1, 1946.

I noted likewise in the Petition for Paul Kershaw, Jr., Docket No. 49929, the same error appears on Page 4. A similar Paragraph on Page 4 of Paul Kershaw's Petition now reads:

"That during the operation of the copartnership from August 1, 1946, to March 4, 1946, and after March 4, 1946, to and including August 1, 1946, there was just one single bank account\* \* \*"

This paragraph should likewise read:

"That during the operation of the copartnership from August 1, 1945, to March 4, 1946, and after March 4, 1946 \* \* \*"

The obvious error of course was the dates should

be August 1, 1945, and not August 1, 1946. This error does not appear in the Petition signed by Robert Azevedo. It is correctly set forth on Page "4" of his Petition.

We therefore respectfully request that this letter be made part of the record which corrects the error which is obvious by changing the date in the paragraph hereinabove referred to from August 1, 1946, to August 1, 1945.

Very truly yours,

/s/ ROBERT C. BURNSTEIN,

RCB/fg

Encl.

(Affidavit of Mailing)

A copy of this letter was mailed to John Potts Barnes, Chief Counsel, Internal Revenue Service, Tax Court of the United States, Washington 4, D. C.

/s/ ROBERT C. BURNSTEIN,

Received and Filed August 3, 1956, T.C.U.S.

The Tax Court of the United States

Docket No. 49896

ROBERT AZEVEDO,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

Respondent.

Docket No. 49928

IRENE KERSHAW,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 49929

PAUL KERSHAW, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Wednesday, June 29, 1955

(Met, pursuant to notice.)

Before: Honorable Marion J. Harrou, Judge.

Appearances:

ROBERT C. BURNSTEIN, ESQ.,

Appearing for the Petitioners.

EDWARD H. BOYLE, ESQ.,

Honorable JOHN POTTS BARNES,

Chief Counsel, Bureau of Internal Revenue,

Appearing for Respondent.

### PROCEEDINGS

The Clerk: Docket 49896, Robert Azevedo and related cases. Please state your appearances, counsel.

Mr. Burnstein: Robert C. Burnstein, if the Court please, on behalf of the petitioners.

Mr. Boyle: Edward H. Boyle for the respondent.

The Court: You may proceed.

Mr. Burnstein: Your Honor, a motion has been filed by both the petitioner's counsel and the attorney representing the respondent to consolidate these matters, and during the course of this argument, your Honor, I will refer to the parties, and unless you request some interruption, I will use specific names, but I will do my best not to take too long in discussing these facts by getting too many parties in.

The Court: Let's find out one or two preliminary things. Is there any objection to a consolidation of these proceedings?

Mr. Burnstein: No, your Honor.

The Court: All right; where is the motion? The motion was filed, was it?



Mr. Burnstein: The motion was filed, your Honor, I believe Monday morning.

The Court: Motion to consolidate is granted. Now, we have the lead case, the case with the lowest docket number, Irene Kershaw, and that will be the name of the case. The year [3\*] in that case is 1946, only, I believe?

Mr. Burnstein: That is right.

The Court: And then in Docket No. 49939, we have Paul Kershaw who, I presume, is Irene's husband?

Mr. Burnstein: That is right, your Honor.

The Court: Docket No. 49896, Robert Azevedo. Who is Mr. Azevedo?

Mr. Burnstein: Your Honor, if I may take one moment of your time, Robert Azevedo and Paul Kershaw, Jr., are the taxpayers who are actually being assessed a deficiency. Mrs. Irene Kershaw is in this only because of her community nature of income as a wife of Paul Kershaw.

The Court: I understand that perfectly well. We go through that all the time. Who is Robert Azevedo?

Mr. Burnstein: Robert Azevedo is an alleged partner during a period of time from August 1 of 1945 to August 6, 1946, with Mr. Paul Kershaw, Jr.

The Court: What is the issue in these cases?

Mr. Burnstein: The prima facie issue, if the Court please, is whether or not during a period of time from March 4, 1946, to and including August 6, 1946, that a partnership consisting of Paul Ker-

---

\*Page numbering appearing at top of page of original Reporter's Transcript of Record.

shaw, Jr., and Robert J. Azevedo conducted the sales of wine, of a California corporation incorporated under the laws of the State of California on March 4, 1946.

The question is whether or not these two gentlemen [4] during that period of time from March 4, 1946, to and including August 6, 1946, were engaged as copartners in the sale of wine or was this sale of wine being conducted by a corporation entity organized and existing under and by virtue of the laws of the State of California as of March 4, 1946.

The Court: The Commissioner has determined that the business was carried on by the partnership; is that right?

Mr. Burnstein: That is right.

The Court: Was there a partnership?

Mr. Burnstein: Yes, your Honor.

The Court: You agreed there was a partnership?

Mr. Burnstein: Yes, your Honor, not during that period. There was a partnership, as stipulated in the facts, from August 1, 1945, to March 1 of 1946, which is in the stipulation of facts as to the existence of a partnership. The Commissioner, of course, doesn't stipulate that the partnership terminated on that date. That is one of the factual problems that we will eventually bring before your Honor this morning, and in our briefs, with your Honor's permission.

The Court: Mr. Boyle, if you would like to file the stipulation of facts at this time, I would like to look at it.

Mr. Boyle: If your Honor please, we are filing these. I have several reservations, or rather, I want

to make clear several points which might be confusing otherwise.

The Court: I would like to go to this stipulation of [5] facts now, if it is all right with you.

Mr. Burnstein: Yes, your Honor.

The Court: What is your objection? There are certain paragraphs in the stipulation of facts about which you have objection, Mr. Boyle?

Mr. Boyle: Well, in Paragraph 11, your Honor, respondent doesn't mean to stipulate that this grant deed took effect on June 21. We merely mean to admit that it was executed, it was dated—we don't know when the date was, whether it was executed on the same date, but we want merely to stipulation—to enter a stipulation that it was executed.

It carries a date of June 21, and it was recorded in November.

Mr. Burnstein: Yes, your Honor. We are not asking the Commissioner to stipulate that the date that the deed bears actually conveyed the title. We believe, if the Court please, that when we are able to discuss this matter in our briefs, and even this morning, if you Honor wants on the question of law, that we would be able to convince the court, we hope, that that in itself is sufficient evidence to show the passage of title, but I am sure the Commissioner did not intend to stipulate that title passed on the 21st of June of 1946; is that correct, Mr. Boyle?

Mr. Boyle: That is correct.

Mr. Burnstein: I am sorry if I worded it in such a [6] way that it is confusing.

Mr. Boyle: We have one other reservation, or want to make clear one other point.

The Court: What is the next point?

Mr. Boyle: In Exhibit 3-C, which purports to be a partnership return running from August 1, 1945, to March 1, 1946, the exhibit attached is a retained copy that the petitioner had.

The Director of Internal Revenue has never been able to find that such a return was filed, and therefore, respondent is not in a position to admit that it was filed when its records do not so indicate. I notice that the copy filed carries no signature. Of course, normally, that means it is no return.

In this case, since it is supposedly a retained copy, that has not the significance it would on a filed copy, but I want to point that out too.

Mr. Burnstein: May I say this, if your Honor please? I can well understand Mr. Boyle's feeling. It wasn't until yesterday, if the Court please, that this matter was brought out. As a matter of fact, the proposed stipulation of facts prepared by the United States Commissioner says that this particular return was filed. This is the stipulation they submitted to me, that Exhibit 3-C was filed.

Mr. Boyle then called me and said to me that the [7] statement in his proposed stipulation saying that this Exhibit 3-C was filed was probably in error. I had never intended to have any witnesses to prove that this matter, that this return was mailed, and Mr. Boyle told me that since this was a matter that was brought up suddenly, since on June



23, his stipulation said it was filed, and I was under the impression that it was.

If it is necessary, we may take the deposition of the accountant who prepared this and said he mailed it: it was a physical impossibility to get it here because I thought it was stipulated to until yesterday afternoon.

Is that correct, Mr. Boyle?

Mr. Boyle: That is almost correct. I think it was the day before yesterday, but certainly it was short notice. I had asked the Director to ascertain whether such a return was filed, and in the meantime, I assumed it was since they had a retained copy, and I put it in my proposed stipulation.

I found from the Director that they had no such return, nor a record of it.

Mr. Burnstein: Your Honor will likewise notice that I didn't wish to take any advantage of Mr. Boyle in this regard, and I said in our stipulation, which refers to Exhibit C, that it was prepared for filing. I won't, under his statement, say that it was filed because he tells me the records do not show it. So I don't intend to say he is stipulating that it was filed, and we can get that evidence for what it's worth as to the making [8] and the preparation and the date of the mailing of the return that is Exhibit 3-C.

The Court: What is the materiality, Mr. Boyle, of the filing of the partnership return for the period August 1, 1945, to March 1, 1946?

Mr. Boyle: I don't believe there is any, your Honor. I have no thought that it is material, but I



did not wish to stipulate to something our records indicated was not so, and that is the only reason.

The Court: That is not my point in asking you that question. I have gone on to another thought. Does it mean something in this case whether a partnership return was filed or was not filed for a period ending March 1, 1946? Does that fact contribute something to an understanding of the issues presented?

Mr. Boyle: This is a factual issue which, brick by brick, will be built up, as a brick in a structure. It has no particular significance, I do not think.

The Court: Well, then, you have explained Paragraph 4 in Exhibit 3-C. I don't see why I should accept Exhibit 3-C unless I know what was done, and we will go back to that later, I guess.

Mr. Boyle: If your Honor please, in order to be completely fair with Mr. Burnstein, he believes that it is very important to his case, and I didn't wish to completely eliminate it. [9]

I did say that I would rather have it put in through the testimony of the accountant, and if he couldn't be here, to do it on deposition; leave the record open and take his deposition later, but it was attached to the stipulation of fact this morning and I thought I would then explain it to your Honor rather than——

The Court: Is there anything else you want to explain?

Mr. Boyle: One more thing. I notice that he does, the petitioner attaches the amended return of the corporation for the year March 4, 1946, to March 3, 1947, and of course, the amended return is not a

return standing alone. Therefore, I believe, to complete the record, we better put in the original, too.

Mr. Burnstein: Yes, your Honor.

The Court: Yes; you would have to do that. I only have one amended return, and that relates to a fiscal year ending March 3, 1947. You were just referring to one?

Mr. Boyle: I merely want to put the original of that return with it.

The Court: Will you bear with the Court a few minutes? I will have to take a recess because of a long distance call.

(Short recess taken.)

The Court: Court is in session again. I will have [10] to go ahead without the Clerk. Will you resume, please, Mr. Boyle? I was asking Mr. Boyle about these matters. I will receive all these exhibits later.

Have you any other problem about the stipulation?

Mr. Boyle: That is the only thing I have about the stipulation of facts, your Honor.

The Court: Mr. Burnstein, you may proceed and tell us what the problem in this case is.

Mr. Burnstein: Yes, your Honor.

#### OPENING STATEMENT ON BEHALF OF THE PETITIONER

Mr. Burnstein: If I may give you a brief history, which will assist the Court in eventually determining the factual facts in the controversy, in July of 1945, a man by the name of Mr. John Azevedo,

who prior to that time, had been the lessor of certain premises which had been improved and constructed for the purposes of manufacturing wine, and a fruit distillery which we laymen, as far as the wine business is concerned—call it a winery, had been leasing these premises to various wine manufacturers, such as Christian Brothers and other organizations.

The Court: Excuse me, please. Your statement isn't clear. Didn't Mr. Azevedo own the property, and was he the lessor or was he a lessee, and then did he sublease?

Mr. Burnstein: He was a lessor, your Honor. Mr. John Azevedo, who is the father— [11]

The Court: Well, he owned land somewhere. Where was that?

Mr. Burnstein: In Sacramento County, in Mills Junction, substantially is the address.

The Court: All right.

Mr. Burnstein: Mr. Azevedo is the lessor and leased this land in July of 1945, approximately in July. But then in the month of July of 1945, he terminated the various relationships of landlord and tenant and lessor and lessee that he had with others, applied for and did receive from the Federal Alcohol Tax Unit, and from the State of California, the necessary basic permits to permit him as an individual to engage in the manufacturing of wine and the distilling of fruit spirits.

He then made arrangements as an individual with the Capital National Bank in Sacramento, California, to borrow approximately \$440,000 in order to

finance the crush—that is, in order to obtain money necessary to go out to the individual farmer, grape grower, buy the grapes, bring them into the winery, crush them and manufacture them into wine, fortified also by distilled spirits.

In August of 1945, which is prior to the actual day when the grapes are physically crushed, but when the grapes were being purchased, and when a loan had been obtained from the Capital National Bank, Mr. John Azevedo entered into [12] certain oral agreements with Robert Azevedo and Paul Kershaw, Jr., the two taxpayers now before this Court.

As a result of these agreements on August 1 of 1945, Mr. Robert Azevedo and Paul Kershaw, Jr., entered into and operated a copartnership, taking care of the crushing problems and the purchase of grapes; that is, the physical and mechanical things necessary to bring grapes into the winery and to have them crushed by the various methods of the grape manufacturing.

On December 1, 1945, or approximately thereto, the grape crush season had been completed in California: that is, all the grapes were finished, crushed and in the process of being finished up for final wine. At that time, Mr. John Azevedo said to his son, Robert J.—who incidentally was a wine maker, educated at the University of California, the Agricultural College for this purpose, and likewise Mr. Kershaw, who was doing some of the selling, the negotiations for the sale of the wine when it came into being, said, “I want something in writing to reflect what your obligations to me are.”



On December 1 of 1945, two agreements were entered into which are Exhibit 1-A and 2-B to the stipulated facts. Thereafter, through December of 1945, and through January of 1946, and through February of 1946, Mr. Robert J. Azevedo and Paul Kershaw, Jr., proceeded to do those things necessary in the trade, what is commonly called "finishing." The wine [13] sediment had to be removed and they had to be tested and other things, and also negotiations were being made for various sales that had not been consummated, but since the wine was coming into being, ready for sale, these things were being done.

On March 4 of 1946, a California corporation was organized under and by virtue of the laws of the State of California, which is still in existence, and operating as a California corporation. On March 4 of 1946, the corporation was organized, and it then sold the wine to various buyers.

It is stipulated that all the wine of the 1945 crush was sold after March 4, 1946, and it is stipulated that all monies that came were in a single bank account, and all expenditures that were incurred by the corporation, and all monies that were spent for improvements were made out of this single bank account.

So that your Honor can understand this single bank account, may I please explain because it is a stipulated fact, and it is important, I believe, to the Commissioner's position, and I believe ours as well.

When Mr. John Azevedo had entered into this



agreement with Robert and Paul Kershaw, Jr., in August of 1945, and they commenced doing business as copartners, Robert and Paul didn't have the necessary permits from the federal government to engage in the manufacturing of wine or the distilling of fruit spirits.

That permit was in the name of John Azevedo; no [14] question about it. However, we will discuss this later on in our argument when your Honor wishes it.

Mr. Azevedo had the bank account; that is, John had a bank account in his name alone, and it was in the Capital National Bank. The monies that were deposited in the bank account prior to March 4 of 1946, came only from loans from the bank. That is, there was no money coming in because no wine was sold until after March 4 of 1946.

Any monies that were withdrawn, any monies that were withdrawn from this bank account from August 1 of 1945 to August 1 of 1946, was only upon the signature of Mr. John Azevedo. After August 1 of 1946, Mr. Paul Kershaw, Jr., and Mr. Robert J. Azevedo were given the authority to draw checks and checks were drawn.

The corporation didn't have any basic permit to manufacture wine nor to distill fruit spirits until August of 1946, August 7. However, the corporation, we contend, did sell wine from March 4, 1946, to and including June 30 of 1946; on or about the 30th day of June of 1946 all of the wine was sold that came from the crush of 1945.

Now, from this single bank account all the part-

nership obligations were paid and from this same bank account all the corporate obligations were paid. All the monies went into this same account and it remained intact except for certain payments that were made to Mr. John Azevedo for corporate [15] obligations which are stipulated to.

During the months of June, July and August certain obligations were incurred for the improvement of the winery premises. This is before the basic permits were obtained in the name of the corporation for the distilling and wine manufacturing.

These obligations were paid by the corporation from this single bank account. The books of the corporation reflected this. Now, when the corporation was organized, it had an opening inventory of \$445,600. That was the same closing inventory of the partnership on March 1 of 1946. The corporation then had the same opening inventory as the copartnership had as a closing inventory.

The partnership, if the Court please, lasted from August 1, 1945, to March 1, 1946; from the return and from the evidence, I believe that we have produced, and the corporation went into existence on March 4 of 1946.

Thereafter, of course, the corporation continued to sell all the wine and all the monies came into the single bank account. On August 7, 1945, the basic permits were issued to the California corporation.

May I just mention this? On June 21, 1946, a deed dated June 21, 1946, was delivered by Mr. John Azevedo to the title company, but it was recorded in November.

In April of 1946, which is likewise an exhibit to our [16] stipulation of facts, the corporation entered into agreements with others in connection with fruit distilling. In May of 1946, likewise which are exhibits to our petition, the corporation entered into licensing agreements with the Southern Pacific Railroad Company in connection with crossings at various grade tracks, which are attached, or by reference, attached to our exhibit.

Mr. Al Becker, which is likewise stipulated to, was employed by the corporation as office manager in April of 1946 and continuously, as it is stipulated to, dealt with, as said employee, until 1950, with all growers, manufacturers, distillers and other persons interested in the fruit processing industries as such an employee.

In essence that is the history. Boiled down to its ultimate facts, that is it. There are many ramifications that Mr. Boyle might want to discuss. The corporation, incidentally, is still in existence. It had stock issued in accordance with the permit issued by the Commissioner of Corporations of the State of California. That stock was not issued until October of 1946. The actual taking over of the distilling and the manufacturing of wine as distinguished from the sale of wine, which is not a basic permit might, or probably didn't come until the corporation received its basic permit to carry on the 1946 crush, which is not a question before this Court. I mention that only for the sake—— [17]

The Court: What was that date?

Mr. Burnstein: The commencement of the 1946 crush, your Honor? I would say the 1946 crush started around September of 1946, when the grapes were about ready for crushing. During all this period of time when the grapes which had been reduced to an inventory and created a wine inventory, this California corporation did sell the wine. It is stipulated in the statement of facts that the monies came into the single bank account, and the obligations were paid from the corporate funds.

We respectfully believe that in essence is a short history as to the background in this case.

The Court: Thank you. Mr. Boyle?

#### OPENING STATEMENT ON BEHALF OF RESPONDENTS

Mr. Boyle: If your Honor please, if we back into this, it will also take on a different perspective. The corporation did file a corporate return for the period March 1, 1946, to March 1, 1947, and the three individuals who are taxpayers here, Robert Azevedo, Paul Kershaw, Jr., and Irene Kershaw, filed individual income tax returns for the year 1946.

The Commissioner has taken the position that the income reported by the corporation, that part of the income reported by the corporation which came from sales made between March 1, 1946, and August 6, 1946, should be the income of the three individuals. [18]

The Court: You mean as members of a partnership?

Mr. Boyle: Probably, yes. The theory, of course, is that John Azevedo, the father, was the only per-



son that had authority to do anything, and the income was really his, but since, under the contract in writing with these two young men, since the contract said they were to manage and operate the premises for him and all profits would become their salary, actually it goes to him and then comes right back out and becomes the income of the individuals.

That is the theory of the Commissioner's case. They were operating as a partnership and we believe they continued to do so. Of course, the facts are entirely confused and mixed. During the period March to August of 1946, the Commissioner takes the position that the corporation was in being, but only just barely alive. It was not actually functioning and it had no authority to do any of these things, and actually didn't become alive until August.

The Commissioner treats it as a valid legal corporation after August, and concedes that all income thereafter belonged to the corporation, but it is that period prior to August of 1946 that we are talking about here, and it is the income during that period that is in issue.

Some of the facts that I might point out——

The Court: Where does this point about the existence of a partnership come in to the respondent's theory, if at all? [19] You say that the whole issue here relates to the period May 1, 1946, to August 1, 1946. That is a period of just three months?

Mr. Boyle: That is true.

The Court: And you say that during those three months there was income from a winery.



Mr. Boyle: Actually four months; from March to August.

The Court: Well, I have down here May—is it March or May?

Mr. Boyle: March 4, that is the day the corporation was incorporated under the laws of California.

The Court: March 4, 1946, to August. That is five months.

Is it your view that during that five-month period there is some income derived from a winery business; is that right?

Mr. Boyle: Actually, it is more specific than that.

The Court: What is it?

Mr. Boyle: It is stipulated that it is the income from the 1945 crush.

The Court: We will just call it then the income from the 1945 crush. And is it your position that that income from the 1945 crush is the income of John, or is it the income of a partnership?

Mr. Boyle: The income of a partnership, but it can [20] only become that way by virtue of going through John in accordance with their written agreement.

The Court: Why is that?

Mr. Boyle: In the written agreement of December, it says, "I will sell to you," the two young men. "at adjusted cost," which is the \$100,000—"the premises here, together with the wine inventory at a price of approximately \$440,000, which represents my indebtedness to a bank in Sacramento, in order to get the crush into the winery."

It further states: "Nothing will pass, not title to

anything will pass until the young men get the basic permits necessary to operate." That is the basic permits from the Federal Alcohol Tax Unit and the State Board of Equalization.

It states, however, that for their salary during all this period, they shall receive the profits that accrue in the interim. The only profits that accrue between that point, December of 1945 and August of 1946, result from the sale of this 1945 crush, and the Commisisoner concedes that the young men operated as a copartnership until March, as does the petitioner, but the Commissioner takes the viewpoint that it continued to operate until August for a number of reasons.

First of all, no basic permits were ever acquired by anyone except John, the father, and his ran from July of 1945 until August of 1946.

In August of 1946, the corporation received [21] the permits necessary from the federal and state authorities. They had made application, it is true, in May, but they were not granted the necessary permits to do business until August.

On that specific point, the Commissioner takes the position that no one had the right to sell this wine except the person with a permit, and only the father John had that. but of course, he was under contract with the young men.

The Court: That is a very important point. I want you to amplify that. No one had a right to sell the wine except the holder of the permit.

What is your authority for that?

Mr. Boyle: We say that under Title 27, United States Code, Section 203 (b) 12, which is under the Federal Alcohol Administration Act——

The Court: What does it provide?

Mr. Boyle: “It shall be unlawful except pursuant to a basic permit issued under this Act by the Administration, to engage in the business of distilling distilled spirits producing wine, rectifying or blending distilled spirits or wine or bottling or warehousing and bottling, distilled spirits or (2) for any person so engaged to sell, offer or deliver for sale, contract to sell or ship in interstate or foreign commerce, directly or indirectly or through an affiliate, distilled sipirits or wine so distilled produced, rectified, blended or bottled or warehouse and bottled”—— [22]

The Court: Where is the “unless.” I am waiting for the tag line on that.

Mr. Boyle: That is true, your Honor. That is the purport of this.

The Court: Unless the person has a special license?

Mr. Boyle: That is correct, except pursuant to a basic permit; that was the beginning sentence.

The Court: Issued under that act by the federal government?

Mr. Boyle: Yes.

The Court: In this business, does there have to be a state permit as well as a federal permit?

Mr. Boyle: There does, your Honor. Of course, I am not going to press down on that point.

The Court: Well, I want to get the whole picture.

Mr. Boyle: I understand there is, yes.

The Court: And John had the state permit as well as the federal permit?

Mr. Boyle: That is my understanding, yes.

The Court: Is it stipulated?

Mr. Boyle: Yes; we stipulated that, that he had the only basic permits that were in existence until August of 1946, and that included the state permits as well.

Mr. Burnstein: That is right.

The Court: Your theory is that proceeds from any [23] sale have to go to the holder of the permit, who is John?

Mr. Boyle: That is one of our reasons, yes, for believing that the income was his, and then to these young men.

The Court: They may have received it directly, but he would receive it constructively?

Mr. Boyle: Yes, your Honor.

The Court: They would receive it as compensation for services. You see, I don't see where a partnership gets into this. Maybe it doesn't make any difference, but if the income should be regarded as belonging to the holder of the permit, the holder of the permit is an individual and if some individuals perform some services and do some work in the business—unless there is this:

Is it contended that there is a partnership with John?

Mr. Boyle: No, your Honor, it is contended that

under their agreement of December, he said that "you shall operate and the profit shall be yours as salary," so if you put it on John's income, it would come right back out as expense.

We are trying to give effect to this written agreement of December, 1945.

The Court: What exhibit is the written agreement?

Mr. Boyle: 1-a and 2-B.

Mr. Burnstein: Your Honor, while this is still fresh [24] in your mind, may I make—without interrupting Mr. Boyle—make a short answer to some of these matters that he has just discussed?

The Court: You will be given an opportunity in just a minute when he finishes his statement.

Mr. Boyle: In addition, it is stipulated that the only bank account was a continuous one which started with the father back in 1945, only he had authority to draw checks and that bank account the young men took over for their partnership, but only he had authority to draw anything out of it, and that continued to exist after the corporation was formed in March and June and in July, and not until August did anyone other than the father John Azevedo have authority to withdraw from that bank account.

All the profits we are talking about from this wine crush went into the bank account, and all expenses came out by checks drawn by the father. So there stands the father with his basic permit and the only authority to act, but agreeing under a



written contract with the young men that the profits are theirs.

In March the young men did form a corporation. That is all they did. Actually, there was no request for the issuance of stock until September, and there was no stock—the State Corporation Commissioner didn't grant authority to issue stock until October, and it was not until August that the [25] corporation filed with the Collector of Internal Revenue Form SS-4, application for employer's identification form. The preceding identification number had been issued to John, which they need, if they have employees, and it was not until subsequent to August that notification of change in ownership of insurance policies and motor vehicles were made by the corporation, and there is nothing in writing or nothing in existence to show how title to any of these premises, the real property or the winery got out of the hands of John Azevedo, the father, into the corporation until November of 1946, when the grant deed was recorded in Sacramento County.

It is true that the grant deed carries a date June 21, but there is no evidence to show when it was put into escrow or when it was delivered. It may have been in the hands of John all that time. We don't know that, but of course, by June 21 the period is almost up anyway because it is stipulated that all these profits accrued prior to June, although we keep talking of August of 1946.

But all the profits accrued between March and June of 1946, so even if you give effect to the grant deed as of June 21, we have only got nine days

left that we would be talking about anyway, and there is no other document to show that title passed from the father to the boys, or the corporation.

Of course, as it actually turned out, the basic permits were never applied for by the young men, as it was set [26] out they should do in the written contract of December.

They went ahead and formed this corporation. They got it started and the corporation applied for basic permits, but the corporation really had no life, is our contention, until August. Apparently, the facts are confused. They were doing things in the name of the corporation, although the invoice headings and all their letterheads just said, "Mills Winery."

The father used that name as a sole proprietor. The boys used that name as a partnership and the corporation used it later, but during this interim period of confusion, from March to August, apparently the boys were doing some things as a corporation and some things not.

But our contention is that the income rightly belongs to the boys because the corporation was not alive enough, although it was a factor in a slight sense, it was not alive enough to say that the income belonged to the corporation.

It is like Holmes said in *Lucas v. Earl*; you have got to leave the fruit to the tree on which it grows, and we think that during that period the boys, through the father, were earning this income.

The Court: So the question here is whether income earned during the period March 4, 1946, to

August 1, 1946, is income of these three individuals or is income of the new corporation? [27]

Mr. Boyle: That is right.

Mr. Burnstein: That is right.

Mr. Boyle: Shall I continue?

The Court: Why do you pick on the date, March 4?

Mr. Boyle: They went down to Sacramento and asked for a charter for the corporation.

The Court: And the petitioner claims that the income is taxable to the corporation right from the day a charter was issued? Was it issued on March 4?

Mr. Boyle: Yes, it was. They say the income belonged to the corporation on and after that date. The Commissioner says, no, not until August 6 which is the day the corporation received its basic permit to operate.

The Court: August 6?

Mr. Boyle: Yes; did the corporation become full fledged.

The Court: On August 6 your point would be that the corporation began to do business?

Mr. Boyle: That is right.

The Court: Began a corporate existence from March 4, but it wasn't actually carrying on this business until August 6; is that your position?

Mr. Boyle: It had an existence in part. It had no stock out; it had no title to anything.

The Court: Just a shell corporation? [28]

Mr. Boyle: Just a shell, yes. It owned nothing. All that existed so far as the Commissioner is con-

cerned, is a charter of incorporation, although it will concede that certain acts were being carried on in the name of the corporation, apparently by the young men.

The Court: Even before they had any stock?

Mr. Boyle: Yes.

The Court: Of course, we understand how those things are done. I suppose, Mr. Burnstein, the Azevedos are Italians?

Mr. Burnstein: Portuguese, your Honor.

The Court: And how old was John Azevedo in 1945?

Mr. Burnstein: John was 56, your Honor.

The Court: Well, he wasn't an old man. He was just middle-aged.

Mr. Burnstein: Yes.

The Court: About how much land did he own up there at Mills Junction?

Mr. Burnstein: That amounts to approximately, I believe, three acres.

The Court: That is not very much.

Mr. Burnstein: No, your Honor.

The Court: Was there a building up there?

Mr. Burnstein: Yes, your Honor. The premises—and I use that in this respect: It had a wine-making chemist [29] building on it, with all the necessary paraphernalia required to make wine. It had the vats, it had a bonded warehouse, it had the crushing machines, the fermentation tanks.

The Court: Well, that sort of equipment doesn't take up too much room. What did he have, three or four small buildings?



Mr. Burnstein: Oh, yes, your Honor, many more than that, they were spread all over.

The Court: What was this winery called when he leased it?

Mr. Burnstein: The winery was run by Christian Brothers, and I don't know what they called it at that time.

Pardon me, if I may. I may ask Mr. Kershaw, who is in the courtroom. Do you know, Mr. Kershaw?

Mr. Kershaw: Christian Brothers Winery.

Mr. Burnstein: They are manufacturers. Your Honor probably might be familiar——

The Court: I have been in Napa Valley, and I have gone by the place called Christian Brothers Winery; is that the one?

Mr. Burnstein: Yes. Well, when you say that one, it is the same organization.

The Court: It is the same organization, and they probably lease various places?

Mr. Burnstein: That is right. [30]

The Court: All right. This was a place leased by the Christian Brothers Winery, and Mr. Azevedo took it back; the lease came to an end or the lease was terminated, and he decided to operate it himself, and he then went into the business of making wine, no doubt Sherry and Port and fortified wines?

Mr. Burnstein: That is right, your Honor. That was his intention until this arrangement with his son and Mr. Paul Kershaw.

The Court: How old was his son in 1945?



Mr. Burnstein: His son in 1945 was in his early twenties.

The Court: How old is Mr. Kershaw?

Mr. Burnstein: Mr. Kershaw was 32, your Honor.

The Court: I would be glad to hear any testimony that might throw more light on this, since Mr. Kershaw is here.

Mr. Burnstein: Your Honor, I don't think it is necessary because I believe—I have no objection, that is why I had him here, if it is necessary and if your Honor would like him to testify.

I respectfully submit this, your Honor, if I may make a few short answers to Mr. Boyle's statements.

First of all, Mr. Boyle has not given your Honor the complete picture on the Federal Alcohol Administration Act, and [31] I don't think he did it intentionally because I think this might be the first opportunity he has had to become involved with the Federal Alcohol Administration in their regulation of wineries.

There are three types of permits, not just one basic permit. First, there is what is called a fruit distiller's permit, which is under the same act that Mr. Boyle referred to.

Secondly, which is a separate piece of paper and separate type of application, called a manufacturer of wine, a winery permit.

Third, is the type of permit which is called a wholesaler of wine. Now, Mr. Boyle takes this major premise, and we respectfully submit that it is highly untenable, and the cases that we have previously

given the Commissioner are contrary to their contention and that is this:

The cases have held, and the regulations with the Federal Alcohol Administration have so decided, that if a particular person, such as a corporation in this case—let's say Mills Winery, obtained a total bulk wine from one seller, at one instance, the sale to many, many different people does not require a basic permit.

You must be engaged in the business of buying for resale which must be the habitual and continuous practice of going out and buying and selling, and it doesn't require a [32] basic permit when you buy 600,000 gallons, and then you just sell it to 35 different people; no basic permit under the Act, and it is that specific.

The Court: You call that a wholesale operation?

Mr. Burnstein: Yes, your Honor.

The Court: I thought you said there was such a thing as a wholesaler's permit?

Mr. Burnstein: There is, but there was a permit in the name of John, but the position that Mr. Boyle takes is that since there is no permit, all of this is illegal; nobody can do it but John.

The Court: No.

Mr. Burnstein: I thought that is what he said.

The Court: The point, Mr. Burnstein, is this: We are concerned here with taxable periods.

Mr. Burnstein: Yes, your Honor.

The Court: And if taxpayers carried on their business operations without being aware, without being sufficiently aware of the need for a certain

kind of timing in order to make the ending of the tax period for one taxpayer perfectly clear, and the beginning of the taxable period for another taxpayer perfectly clear, then, of course, he is subject to some determination by a tax official, which is made just for the purposes of taxation.

Mr. Burnstein: Yes, your Honor. [33]

The Court: Some taxpayers will accept those determinations; sometimes they are contested. Here you have some income for a three-month period. Why is it so vital to you whether you accept the Commissioner's determination or not?

Mr. Burnstein: Why is it so vital?

The Court: Yes. The taxpayers, these people carrying on a winery business up in Napa, did they have an accountant? Did they have a tax adviser, or did they——

Mr. Burnstein: What people, your Honor?

The Court: The Azevedos.

Mr. Burnstein: They were in Sacramento, your Honor.

The Court: All right; while they were getting organized, so to speak for this business, the Senior Azevedo had leased property at the Christian Winery?

Mr. Burnstein: Yes.

The Court: And he decided to go into the wine-making business and use this winery?

Mr. Burnstein: He was willing to set his son up in business; perhaps that is why he terminated the lease to Christian Brothers winery; the boy was getting out of University of California. He had pre-

pared to go into the wine-making business; the father had a winery and the father said, well, now, take this over and go into business and get Kershaw to go into it. [34]

How old is Mr. Kershaw?

Mr. Burnstein: He was 32 at that time, your Honor.

The Court: And Mr. Kershaw was older than Mr. Azevedo's son?

Mr. Burnstein: Yes, your Honor.

The Court: Had Mr. Kershaw had experience? Was he an experienced man?

Mr. Burnstein: Yes, your Honor.

The Court: Well, for some reason or other, the owner of the property decides that the business will be operated on that piece of property. How was John Azevedo to get anything out of that? Was he to be a stockholder of this new corporation?

Mr. Burnstein: No, your Honor.

The Court: Was he to lease the property to the corporation?

Mr. Burnstein: No, your Honor. He was selling.

The Court: He deeded the property?

Mr. Burnstein: That is right, your Honor, and he was paid.

The Court: He sold the property?

Mr. Burnstein: That is right.

The Court: Is that stipulated?

Mr. Burnstein: That is in the stipulation.

The Court: How much did he sell the property for? [35]

Mr. Burnstein: \$100,000, and at an adjusted cost of \$10,000; \$110,000.

The Court: So in the process of arranging things, there are several things done that run into the realm of taxes, and unless people do these things with the help of an accountant and a tax advisor at the time, it is quite easy for timing to be such that it isn't easy for the agent to determine where the tax period for one taxpayer ends and the tax period for another taxpayer begins.

These situations are all the creation of the taxpayer. What is there about this determination that is so unacceptable to the taxpayer?

Mr. Burnstein: Well, first of all, when you say "unacceptable" to the taxpayer, we respectfully believe that the position of the Commissioner is erroneous on all the facts that have been stipulated to, and the law that has decided cases such as these.

Secondly, to be very realistic about it, the difference in the tax is \$118,000. That is one of the things your Honor asked why they are so concerned; there is \$118,000 difference for those four months, and we respectfully believe, forgetting about the dollars and cents problem—that, of course, is the material problem on the eventual payment, but looking at this purely upon the facts and the position that the Commissioner has taken, we believe that their position can't [36] be sustained.

I honestly believe, your Honor, that when we have an opportunity to brief this, I think that I will be able to submit to your Honor cases of similar type, not within wineries but cases of what we call corpo-



rations, as they say, with a lot of meat on their bones, that are almost identical to a situation like this where the Court has upheld the taxable situation to the corporate entity and not to some alleged partnership.

I say that for this reason also, your Honor, and I want to show the inconsistency of the government's position on this, just as an academic question which has become a very important thing.

We have stipulated that this was a partnership from August 1, 1945, to, we say, March of 1946; the Commissioner says to August of 1946. But in the next breath they say this to your Honor, and your Honor asked the question:

Do you mean to say that the only person that has a right to sell this wine and a right to the income would be Mr. John Azevedo because he has the basic permit?

Well, in one breath they are saying this. For what it's worth I can give you cases that bring out this a little clearer, your Honor, if your Honor wants them. In one breath they say the corporation had no basic permit; therefore, no bones, no flesh on the corporation, but we are going to recognize the partnership, although it had no basic permit [37] because that had not too many bones or flesh on it, but we are going to give effect to this agreement of December 1 and August of 1945.

I honestly say this, your Honor, that the position is inconsistent. It has been held in these cases—and *Morrissey vs. United States* is one of the most interesting cases, that even when there is a corpora-

tion that requires a permit to engage in business—I am not saying that we needed one in this case, but let's assume that we did—even when a corporation needs a permit to engage in business, if it does those things in connection with the purpose for which the corporation is organized, the failure to have a permit shall not permit the courts to disregard the corporate entity.

The Court: The Morrissey case doesn't involve any permit, did it?

Mr. Burnstein: No, your Honor.

The Court: The question in the Morrissey case was whether business was carried on by individuals whose taxable—it was an association taxable as a corporation.

Mr. Burnstein: That is right.

The Court: It is one of the leading cases, but it is not a case that involves the question of a permit, qualification to do any certain kind of business.

Mr. Burnstein: No; if I recall correctly—and I will stand corrected—— [38]

The Court: Of course, if your point is that the individual should be regarded as an association, taxable as a corporation, up until the time the corporation is actually functioning, then I would get your point.

Mr. Burnstein: That is exactly what I am.

The Court: Is that what your point is?

Mr. Burnstein: Yes; their position is so inconsistent, and I have pointed this out before in our letters. I can't follow their major premise upon which they have attacked this, as in the opening

statement that Mr. Boyle has given you this morning.

If they are going to go the way they said, in the corporation, they would be in line with the Morrissey case situation. Whether I am right or wrong. I would like to have the opportunity to brief that matter because I think that we have authority to support us.

I honestly believe this, your Honor. I don't think a permit was necessary, if the Court please, and I think I can convince your Honor that a permit was not necessary for the corporation to do what it was doing.

The Court: I don't think, Mr. Burnstein, that the respondent's position is based solely upon that matter of who had a permit to manufacture wine and distilled spirits. As I understand the respondent's contention, this is a cumulative matter.

There are a good many things that were not done, and [39] taking all of them into account, the Commissioner determines that the corporation didn't start to do business until a certain date.

Mr. Burnstein: I would like to, if the Court please, in line with what your Honor just said, offer into evidence just for the purpose of showing upon—showing the basis upon which the Commissioner has started this assessment, and this deficiency of the revenue agent's report.

The Court: I am not sure that you can introduce into evidence the revenue agent's report.

Mr. Burnstein: I have authority for it, I think, your Honor, based upon your Honor's statement. I

have authority for the fact that we may introduce into evidence the——

The Court: Do you have the revenue agent's report?

Mr. Burnstein: No, I haven't, but I would get it prepared and I will keep the record open to offer it, if I may.

The Court: How do you think you are going to get it, Mr. Burnstein?

Mr. Burnstein: Well, I would say this. I think Mr. Boyle and I could stipulate that the revenue agent's report that was attached to the thirty-day letter is the report that was filed with the Commissioner.

The Court: Well, I don't think you have ever tried to get one of those revenue agent's reports in evidence, and you better find out first all of the difficulties in doing that [40] because it is a hard thing to do.

Mr. Burnstein: May I ask this?

The Court: Because of rules of the Bureau of Internal Revenue about those reports.

Mr. Burnstein: Yes, your Honor.

The Court: They do not have to release them and you would have to find out whether the respondent will release that report, and we can't force them to release the report, either, you see.

Mr. Burnstein: Yes; I understand that, your Honor, but I was assuming, maybe presumptuously, that the report of the agent which was embodied in the 30-day letter notice, which is substantially prob-



ably what the report had, other than extraneous things that the Court couldn't take notice of anyway, since it is not evidence—could be arrived at by Mr. Boyle and myself, which would show the basis upon which the alleged deficiency has been made.

I only say that for this reason, your Honor—and I don't want to belabor this point. I only say it for this reason: that I respectfully believe that there are enough facts here for the corporation to be construed to be in existence as of the time this income was earned.

I do believe that an undue emphasis has been placed upon, even after your Honor has an opportunity to read the stipulation of facts, upon the lack of the license. The [41] license seems to be the thing that is the important matter in so far as the corporate entity is concerned.

The Court: Let me just call your attention to another principle in this field of taxation. I think you are going to run into it here.

Mr. Burnstein: Yes, your Honor.

The Court: Income sometimes derived from property, earned by property and in other instances income is the result of an individual's services, labor and so forth.

Mr. Azevedo, when he took over the winery from Christian Brothers in the first instance, went ahead into one season of production. That was what you have termed as the crushing season. His capital was used to purchase grapes; grapes were then crushed; the liquid was treated in various ways



and then the result of that operation was a marketable product.

Mr. Azevedo owned that product. He then sold it; the income produced by that property as a result of the sale of the property belongs to the person who owns the property. There is where you begin to analyze your problem in this case. Who owns the property that was sold? Who sold the property? He may have had agents selling for him; he may have had an agreement with people to pay them for their services, or to give them a share of the profits for some reason or other.

There is the starting point. Another taxable [42] entity comes into being. I don't think actually that this matter of who had a federal permit is necessarily the most critical point in this case. We have to always get back to the basic question of who owns the property that produces income, or who renders the services that produce income.

If there is some property in existence, and a new taxable entity is created, such as a corporate entity, there has to be a formal transfer of property, and it is a formal matter. It can't be handled loosely. Then what property are you going to be concerned with? There are two or three kinds of property here.

Mr. Azevedo can convey realty to a corporation, or he can convey realty to some individuals. He can have an inventory of wine on hand; that can be conveyed. If the parties handle these things in a loose way without paying any attention to tax consequences, that is just too bad, and although we

understand in this work that people in cities are more likely to have tax accountants and technicians at hand, and around them, people in small towns—Sacramento is not a small town; Sacramento is the capital of the state, and it has a thriving business. It is an important community; it is not like St. Helena in Napa Valley.

Mr. Azevedo isn't a businessman in St. Helena or in Napa, he is up in a good-sized city in this state where there are banks, lawyers, tax advisers, accountants and so forth. [43] Mr. Kershaw, who is here in the courtroom, looks as though he is a gentleman who has had some experience in business. So why things were handled loosely is something that you really have got to explain. It does make a great deal of difference tax-wise, whether the income is taxed to the corporation or whether it is taxed to the individuals, of course, but taxation is so very serious that things have to be handled carefully, and with some measure of exactitude.

So just remember that you have got to look at these points of who owns property, when does title pass, and who earns income.

The stipulation of facts is received and made part of the record.

Mr. Boyle: If your Honor please, I did not quite complete my statement. I was waiting——

The Court: All right; I will complete what I am doing. I thought you had completed. If you haven't completed what you are saying, then don't stop. You stopped.

Most of these exhibits are returns, or purported returns. I will receive some of these now.

3-C is received in evidence; that has been explained. No question about 4-D. That is the amended return of the winery for the period March 4, 1946, to March 3, 1947. That is received in evidence as Exhibit 4-D.

Why are you introducing in evidence the returns of [44] the petitioners, just because that is the usual thing to do? Is there any problem about it, 8, 9 and 10?

Mr. Boyle: That has to do with an alternative that I would like to present now. We have the real question before us, is there taxable income for this year, and I have an alternative approach.

The Court: Well, up to now you haven't said one thing about an alternative approach. I will take that up in a few minutes. I want to inquire about some of these agreements.

The last exhibit you have marked is 10-J, I believe, is that right?

Mr. Burnstein: That is right, your Honor. The last exhibit on the stipulated fact is 10-J.

Mr. Boyle: If your Honor please, we handed out originally——

The Court: I will come to that in a minute, Mr. Boyle.

Is the original return of Mills Winery for the period March 4, 1946, and March 3, 1947, to be received as a joint or as an individual exhibit?

Mr. Burnstein: We will accept it as a joint exhibit, your Honor.

The Court: That will be received as 11-K in evidence. The clerk may mark these exhibits. We will take a recess for a few minutes. [45]

(The documents above referred to were received in evidence and marked Joint Exhibits 3-C, 4-D, and 11-K.)

(Short recess taken.)

The Court: Mr. Boyle, have you something further in connection with your opening statement?

Mr. Boyle: Well, if your Honor please, would you care at this time to receive the alternative argument?

The Court: Yes; I want to know everything that is involved in this case, as part of your opening statement.

Mr. Boyle: The respondent presents this as an alternative: That if the Court should find that this income that is in issue here belonged to the corporation and was returnable by the corporation, that then the young men, Robert Azevedo and Paul Kershaw, Jr., in the year before the Court, 1946, nevertheless did receive a dividened of \$50,000 apiece inasmuch as the father was paid that amount; actually he paid \$110,000, but the adjusted agreement, or the adjusted price to him was \$100,000 as set forth in the agreement of December.

He did receive that money and it was paid out of this one fund, and if the Court finds that it was the corporation's fund, then the corporation paid an indebtedness of the young men which they never

paid back to the corporation, and therefore, they did receive dividends of \$50,000 apiece by the fact the corporation paid that indebtedness of theirs, and in that [46] respect, I will offer in evidence the corporate income tax return for the period March 1, 1951, to February 29, 1952.

The Court: Any objection to that exhibit?

Mr. Burnstein: Yes, your Honor.

The Court: State your objection.

Mr. Burnstein: Our objection to the offering of this exhibit on the basis for which it is offered is on the grounds that even construing the liberal method in which the Tax Court has the right to make a determination on the deficiency, that this is beyond the issues of the pleadings raised before this Court.

On that basis I think primarily that is my objection, your Honor.

The Court: This is not the proper time to offer exhibits during the conference. The Court indicated to you that the Court feels it would be necessary to take some testimony in this case. Therefore, we will go on to a trial of the case, and when we get into that, that will be the proper time for you to offer your exhibits.

The petitioner's counsel has raised the point about the pleadings, and the Court was going to raise the same question. Where in your pleadings do you raise the issue that an amount of income was realized constructively by these taxpayers in the alternative, in the amount of \$50,000 each? I don't see that in your answer. [47]



Mr. Boyle: They are not in the pleadings, your Honor.

The Court: Well, even though it is a rule of this Court that we will not consider questions not covered by the pleadings, and you run a risk, but you can argue—this case seems to be just 95% argument at the present time—you can argue in your briefs that the issue pleaded is broad enough to cover the question, but you run a risk in doing that because the Court might rule when it takes the case under submission that the pleadings are not broad enough to cover that question.

Mr. Boyle: Yes, your Honor.

The Court: At any rate, I think, if you are going to raise that question, I think you ought to amend your answer and raise it clearly in your pleadings.

Mr. Burnstein: Of course, your Honor, just for the sake of the record, we would——

The Court: Will you rise, please, when you address the Court?

Mr. Burnstein: For the sake of the record, in response to your Honor's statement of amending the pleadings, we would at this time object to any permission being granted at this very late and dilatory method of amending.

The Court: You think the amendment at this time would be untimely?

Mr. Burnstein: I think so, your Honor. [48]

The Court: We will wait and see whether Mr. Boyle is going to amend his answer. You can make your objection at that time.

Mr. Burnstein: Thank you, your Honor.

The Court: There are exhibits that were offered and which were attached to the stipulation of facts which the Court has not yet received in evidence. I will take that up this afternoon.

I understand that there are witnesses here who are available to respondent. Respondent has the burden of proof in this case, and those witnesses are asked to return this afternoon. We will recess until two o'clock.

Mr. Burnstein: Thank you, your Honor.

(Whereupon, at 12:15 o'clock, p.m., a recess was taken until 2:00 o'clock, p.m. of the same day.) [49]

(After Recess.)

The Court: Would you proceed, Mr. Boyle?

Mr. Boyle: Mr. Kershaw, would you please take the stand?

The Clerk: Please state your name and address for the record?

Whereupon,

PAUL KERSHAW, JR.

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Witness: Paul Kershaw, Jr.

The Clerk: And your address?

The Witness: Route 2, Box 2652, Sacramento, California.

(Testimony of Paul Kershaw, Jr.)

Direct Examination

By Mr. Boyle:

Q. Mr. Kershaw, are you one of the Petitioners in this case?      A. I am.

Q. Are you in business today?

A. I am an officer of a corporation.

Q. What is the name of the corporation?

A. Mills Winery.

Q. What is the nature of the activity performed by the [50] corporation?

A. Distilling and producing wines.

Q. Where is it located?      A. Sacramento.

Q. For how long have you been an officer of the corporation?

A. Approximately nine years.

Q. Can you give a beginning date for that activity?      A. March 4, beginning, 1946.

Q. Do you know John Azevedo?      A. Yes.

Q. Did you ever have business relations with John Azevedo with regard to the Mills Winery property and premises at Mills Station?

Mr. Burnstein: If the Court please, I would like to have some statement by counsel for the proper foundation as to when——

The Court: Will you please rise when you address the Court?

Mr. Burnstein: I am sorry.

The Court: If you have an objection to make, make it.

(Testimony of Paul Kershaw, Jr.)

Mr. Burnstein: I have an objection upon the ground——

The Court: The objection is overruled. Proceed, Mr. Boyle.

Q. (By Mr. Boyle): Did you ever have a business relation with John Azevedo in connection with the premises of the Mills Winery at Mills Station, California? A. I did.

Q. Did you have business relations with him in 1945? A. I did.

Q. Would you relate those business relations?

A. Well, about in July of 1945, John Azevedo had taken his winery to put into operation and to crush grapes and make wine, About August 1, the following month, why, we entered into an agreement that Robert Azevedo, his son, and myself, would purchase the winery from him, and that we would proceed, beginning then as partners, which we did so until March 4, 1946.

Q. Did you ever reduce your understanding to writing?

A. Not at that time. It was oral agreement, but I believe around in December when we were through crushing and there had been obligations made at the bank by John Azevedo and the crushing was over with, we had made all the wine, he felt that something should be put in writing of what we had originally agreed to.

Q. How many documents were reduced to writing, one or more?

(Testimony of Paul Kershaw, Jr.)

A. I believe so, yes.

Q. How many? [52] A. Two.

Q. I show you Exhibits 1 and 2, 1-A and 2-B, and ask you if those are copies of the written agreement between you and John Azevedo, you and Robert? A. Yes.

The Court: Mark this for identification, please, Exhibits 1-A and 2-B.

(The document above referred to was marked Joint Exhibits 1-A and 2-B for identification.)

Mr. Boyle: If I may ask the Court a question, shall I proceed as if this is not in evidence, nothing in evidence?

The Court: Those two exhibits have not been received in evidence.

Mr. Boyle: I have here 3-C and 4-D and 11-K have been received.

The Court: Those were received in evidence, yes, that is right.

Q. (By Mr. Boyle): Mr. Kershaw, would you state the nature of your duties and the work performed by you during the period beginning December 1, 1945, and ending March 1, 1946?

A. Well, at that time, the wine was completed and I was then—it was my duty then to see and watch the market and to line up sales for this wine.

Q. And did you do that? Were you engaged in this [53] activity full time? Was that the only busi-



(Testimony of Paul Kershaw, Jr.)

ness undertaking that you engaged in at that time?

A. From December to March, I believe so.

Q. And were you in partnership during that time with Mr. Robert Azevedo?

A. That is right.

Q. And will you state whether you know whether that was his fulltime occupation during that period?

A. It was.

Q. Will you state the nature of your duties and work performed between March 1, 1946, and August 6, 1945?

A. I handled the sales of wine.

Q. In the same manner that you had prior to that time?

A. That is right.

Q. And could you state as to the activities or work performed by Mr. Robert Azevedo during that period of March to August, 1946?

A. Robert Azevedo was our winemaker.

Q. Was he engaged fulltime during that period?

A. Yes.

Q. What did you receive for your services during the first period from December, 1945, to March 1, 1946?

A. I didn't receive anything for my services.

Q. What was your understanding as to your salary or compensation? [54]

A. Between that period we were partners, and there was no salary.

Q. What did you anticipate might be the source of profit to you and your partner?

A. We had no idea between—we were just com-

(Testimony of Paul Kershaw, Jr.)

pleting our wine and the market showed no indication of what the price would be. In fact, it started to develop in late February. There was no way of knowing how much profit—in fact, there is never any way in the wine business of knowing.

Q. What did you anticipate might be the source of your profits at any time during the year 1946?

A. There was no way of knowing.

The Court: What was the source, the sale of wine?

The Witness: Oh, yes; through the sale of wine.

Q. (By Mr. Boyle): Exhibit 1-A states that you and Robert were to pay John Azevedo \$100,000?

The Court: It doesn't, Mr. Boyle. Exhibit 1-A does not refer to any amount of money. I am sorry to contradict you. You may look at the exhibit again, if you wish.

Q. (By Mr. Boyle): Mr. Kershaw, I show you Exhibit 1-A and direct your attention to Paragraph 3—I beg pardon, Paragraph 1 and ask you to please read that.

“It is mutually understood and agreed by and between [55] the parties that seller will sell to purchasers a certain winery known as Mills Winery, located at Mills Junction, California, together with all the assets pertaining thereto for the adjusted cost of said winery, plus all other of said winery, including inventory at cost price.”

What is your understanding as to the amount of the adjusted cost you were to pay John Azevedo?

(Testimony of Paul Kershaw, Jr.)

A. Well, I understood we were to pay him \$100,000.

The Court: How did you have that understanding? Who arrived at that figure?

The Witness: That was John Azevedo's figure.

Q. (By Mr. Boyle): Did you and Robert Azevedo pay John Azevedo \$100,000?

A. I believe it was \$110,000.

The Court: Will you wait a minute? Mr. Burnstein, will you come up to the bench, please?

Mr. Burnstein: Yes, your Honor.

The Court: Read that last question?

(Question read.)

The Court: Mr. Kershaw, now whether or not it was \$100,000 or \$110,000, the question is did you pay an amount of money to John Azevedo, you and Robert?

A. We did.

Q. When did you make that payment? [56]

A. It was different payments that we withdrew from the corporate funds.

Q. Did you make it by check?

A. There was a check drawn from the bank account for that.

Q. In what year did you make payments? Were they made at various times?

A. Various times in 1946.

Q. All the payments were made in 1946?

A. Yes.

Q. Where did you get the money to make the

(Testimony of Paul Kershaw, Jr.)

payments?           A. From the corporation.

Q. Where did the corporation get the money?

A. From the sale of wine.

Q. How did the corporation get the wine?

A. From the partnership.

Q. How did the partnership get the wine?

A. They produced the wine.

Q. Did the partnership have any money?

A. The money was borrowed from the Capital National Bank at Sacramento.

Q. By whom was it borrowed?

A. Mr. John Azevedo made the arrangements for the loan.

Q. Was it loaned to John Azevedo?

A. It was. [57]

Q. Wasn't it his money?

A. Well, with our agreement that we were partners, we understood that it would be ours.

Q. Did you and Robert ever sign a note to the bank?           A. No.

Q. Did you put any capital into this alleged partnership?           A. No.

Q. Did Robert put any capital into the alleged partnership?           A. No.

Q. Who put capital into it?

A. There was no capital. It was all borrowed from the bank.

Q. Well, you can get capital by borrowing capital. Is John Azevedo supposed to be a member of this partnership?           A. No.

Q. Mr. Kershaw, assuming, without deciding—

(Testimony of Paul Kershaw, Jr.)

I won't make any decision on the point, but assuming without deciding that you and Robert formed a partnership orally?      A. Yes.

Q. It would be a partnership in which neither of you contributed any capital?

A. That is right.

Q. What was the business of the partnership supposed to be? [58]

A. The partnership was producing wine.

Q. It was going to enter into the business of making wine?      A. Yes.

Q. From the introductory statement of counsel the Court understands that in order to make wine you would have to buy grapes or other fruit and crush it, and so forth?      A. Yes.

Q. You have to have money to carry on the business?

A. Well, that money was borrowed from the Capital National Bank. The Capital National Bank was willing to finance the complete crush, 100% through the loan.

Q. But the loan was made to John Azevedo?

A. That is right.

Q. Did he in turn loan the money to you and Robert?      A. It was for the partnership, yes.

Q. Was the bank repaid?      A. It was.

Q. Out of what?

A. The bank was repaid from the sale of the wine during the period of the corporation, who assumed the liabilities of the partnership, and liabilities on the wine.



(Testimony of Paul Kershaw, Jr.)

Q. How much money was borrowed from the bank?

A. I believe, your Honor, it was around \$440,000.

Q. When was that money borrowed? [59]

A. In the fall of 1945.

Q. Was the partnership in existence in the fall of 1945? A. That is right.

Q. When was this alleged partnership formed?

A. August 1, 1945.

Q. Then the partnership purports to purchase the winery from John Azevedo; is that right?

A. In December.

Q. That is the idea, that the partnership purchase the property? A. That is right.

Q. For \$110,000? A. Yes.

Q. That makes a total indebtedness of this alleged partnership of \$550,000. That is a lot of money. Where are your books?

A. Where are our books?

Q. Did the partnership keep books?

A. The partnership kept books, yes, but when I state books, the partnership kept a check ledger showing all the expenses paid out and the loans that were made, and the amount of money owing to the bank.

The Court: Mr. Boyle, when you resume your direct examination of Mr. Kershaw, would you please make a note that there is a purported indebtedness of the partnership allegedly [60] formed on August 1, 1945, in the amount of \$550,000?

In answer to your question that \$110,000 was paid

(Testimony of Paul Kershaw, Jr.)

to John Azevedo by this alleged partnership, the witness stated that the payment was made out of the proceeds from the sale of the inventory of wines. I do think that you ought to lay some foundation here.

I understand that there are no books of records here, but there is a necessity for us to find out what the net proceeds from the sale of the inventory amounted to. Did they get \$550,000? Did they have that large an inventory?

You indicated this morning that you thought you would like to offer into evidence the corporation income tax return. The corporate returns would be for a later period than this. We did receive something in evidence, the original amended corporate return for the period March 4, 1946, to March 3, 1947.

There was received as a Joint Exhibit, 3-C, a copy of what purports to be a retained copy of a partnership return of Mills Winery for the period August 1, 1945, to March 1, 1946. At I understand it, there is no record in the collector's office of a partnership return ever having been filed. This return names Paul Kershaw and Robert Azevedo as the partners, and shows inventory beginning the year, none; inventory at the end of the year, gross profit, \$32,875.86.

I must say that I still can't see how this operation [61] was carried on, because the profit of 32,000, that is gross profit and not net, ordinary net

(Testimony of Paul Kershaw, Jr.)

income reported for the year of operation of the partnership. When did this partnership end, Mr. Kershaw?

The Witness: March 1, 1946.

The Court: That is your contention?

A. Yes.

The Court: The government contends that it did not end until August 1, 1946, about then. A taxable period which seems to be the one and only taxable period of the purported partnership is indicated. The partnership doesn't make enough money to pay off this indebtedness of \$450,000, or rather, \$550,000. That is exactly the point that disturbed me since we started this morning, and it is the reason why I have been reluctant to have you submit this case on a bare stipulation of facts.

Is there anything in your stipulation that indicates the source of the payment of any money to John Azevedo?

Mr. Boyle: I believe there is in part, your Honor. I can clear up that point, I believe.

The Court: I would like to have you clear it up.

Q. (By Mr Boyle): Mr. Kershaw, at the time you had your oral understanding with Mr. John Azevedo in August, 1945, had Mr. John Azevedo borrowed [62] some money from the Capital National Bank of Sacramento?

A. He had made arrangements to borrow money. I do not believe on August 1st there was money borrowed.

(Testimony of Paul Kershaw, Jr.)

Q. Whatever the arrangements were when they came to fruition, how much was borrowed?

A. About \$440,000.

Q. At the time you entered into your written contract in December, do you recall whether the contract stated that you were acquiring it strictly for \$440,000 indebtedness that John owed the bank?

A. I don't—

The Court: What agreement are you referring to, 1-A or 2-B?

Mr. Boyle: 1-A, your Honor.

The Court: What is your understanding of what 1-A is? It is not a partnership agreement, is it?

Mr. Boyle: No, your Honor. I understand that this constitutes the agreement between the parties; that is, John the seller and the two men buying, that they were to buy—

The Court: Read the last question?

(Question read.)

The Court: Will you reframe your question to make it clearer? [63]

Q. (By Mr. Boyle): What did you purport to buy at the time you entered into the arrangement or the contract with John Azevedo?

A. The winery.

By the Court:

Q. What do you mean by that?

A. The physical property of the winery itself: the buildings and land.

Q. Realty? A. Yes.

(Testimony of Paul Kershaw, Jr.)

Q. Buildings? A. That is right.

Q. How many buildings were there?

A. Oh, around five buildings, your Honor.

Q. (By Mr. Boyle): At the adjusted basis of \$100,000; is that right? A. That is right.

O. And you also purported to buy an inventory of wine constituting the '45 crush; is that right?

A. No; we entered into an oral agreement before there was any wine made.

Q. But in reducing it to writing, did you purport to buy the inventory then on hand?

A. I don't believe that was in the contract.

Q. What happened to the inventory?

A. Well, the inventory at the beginning of August 1, [64] which we agreed to accumulate this inventory under a partnership. The reason for the contract to speak of December 1st was because John felt that the crush was over with, that we had accumulated this inventory, that he had signed notes at the bank and he felt he should have something in writing besides an oral agreement.

Q. It says under Paragraph 1: "Adjusted cost of said winery plus all other of said winery, including inventory, at cost price."

Did you buy the inventory at cost price?

A. It is hard for me to say that we bought the inventory when it was already agreed that inventory was ours.

Q. What did you pay for the inventory?

A. The money that we borrowed from the bank would be the cost price of the inventory.



(Testimony of Paul Kershaw, Jr.)

Q. Then your position is that you borrowed the money from the bank, the \$440,000 to acquire the '45 crush; is that right?

A. John Azevedo borrowed it for us, for the partnership.

The Court: Was that because you didn't have any line of credit with the bank?

The Witness: That is right.

Q. (By Mr. Boyle): Then, in other words, you acquired the inventory by taking over that indebtedness of \$440,000, which was to be paid [65] back to the Capital National Bank of Sacramento; is that correct?

A. Well, when you state that we acquired it, to me it seems that you are asking did we buy this inventory after it was made for \$440,000. Well, that was not the case. We had no inventory to start with. This was an inventory that accumulated in our partnership, oral agreement.

Q. When did you first start buying grapes from the farmers?

A. In the month of August. We had an early season that year; it was early in August.

The Court: If I may interrupt you here.

By the Court:

Q. If I understand you now, you and Robert had no line of credit with the bank?

A. That is right.

Q. The father John did have?

A. That is right.

(Testimony of Paul Kershaw, Jr.)

Q. He borrowed \$440,000 from the bank, gave his note, is that right?

A. That is correct.

Q. Turned it over to you and Robert?

A. That is right.

Q. And then who actually went out and bought the grapes? A. I did, your Honor. [66]

Q. What did John Azevedo do?

A. Mr. John Azevedo was a contractor prior to owning the winery and there was remodeling to be done on the plant, and he stayed there for the purpose of helping us receive the money in the bank and supervising certain construction work at the winery. The son was the winemaker and I was out purchasing grapes for the winery.

Q. And John Azevedo was not in the wine-making business at all, is that a fact?

A. He was there present, but——

Q. What was his regular business in 1944?

A. He was a contractor.

Q. What did he do, build houses?

A. Yes; he built large buildings. In fact, in Sacramento he built the fair ground stands; I believe the motor vehicle department, a very large building.

Q. Does his building and construction business have a name, or does he do it under a certain name?

A. I believe under the name of Azevedo.

Q. It has been stipulated, or the Court has been told that Mr. Azevedo rented the Mills Winery to the Christian Brothers Winery; is that right?

(Testimony of Paul Kershaw, Jr.)

A. That is right.

Q. When did he take back that property?

A. In 1945. I don't know the exact date of the relationship [67] between the person who was leasing the plant, but I think it was the end of June that he took back the plant.

Q. This may be getting into his end—I am afraid a little of it is, but we will have to proceed in this way because John Azevedo isn't here. He is not here, is he?           A. No.

Q. Did he say to you that he was going to operate the Mills Winery?

A. Yes; he had intentions of operating it when he took the plant back.

Q. Did he ever operate it?

A. Well, your Honor, in July his intentions were to operate the plant, and I was called in at that time to take care of sales.

Q. Where had you been working?

A. I was in Oakland, up here in Oakland and in August John Azevedo decided he would step out of the picture before we started to produce anything at all, and that he would sell half the winery to his son and the other half to us if we wanted to take it over for a certain sum of money.

Q. "Us," meaning you and your wife?

A. No; myself and Robert Azevedo, the son.

Q. Well, you said he would sell one-half to Robert and one-half to "us." You mean to yourself?

A. I meant to myself. [68]

Q. And did he do that?           A. Yes.

(Testimony of Paul Kershaw, Jr.)

Q. Then at what point was the money borrowed from the bank; was that before or after the oral agreement was made between you and Robert?

A. After, your Honor.

Q. What were the circumstances under which this oral agreement was made between you and Robert? A. That we would be partners.

Q. How did you come to enter into that agreement? A. Well, the agreement was——

Q. Is Robert Azevedo here? A. No.

Mr. Burnstein: No, your Honor.

The Witness: The father was—John Azevedo was the one who had the sole idea of selling out and offering this to us, which we accepted.

By the Court:

Q. What were the terms of this oral partnership agreement?

A. That we would be partners and that we would split our profits, and that we would——

Q. On what basis would you split your profits?

A. The profits from the business itself.

Q. On what basis? [69] A. Fifty-fifty.

Q. Go ahead. A. What question?

Q. What were the other terms of this oral agreement under which you were to carry on the business in partnership? It takes a lot more to carry on the business in a partnership than you have already set forth. Tell us the whole story.

A. To acquire the winery we would be obligated to pay John Azevedo a certain sum of money.

Q. Listen, this is a tax case, and we are awfully

(Testimony of Paul Kershaw, Jr.)

interested in figures. Don't tell us "a certain sum of money." A. \$110,000.

Q. Go ahead.

A. And we went out and proceeded to make wine. I was buying grapes; Robert Azevedo was the wine-maker. The father was able to go to the bank and make loans for us and we both sold our crush. Our crush ended around December, as I stated before, and Mr. John Azevedo said that now that the crush was finished and the wine was made and that he had signed these notes he felt he should have something in writing from us in regards to our partnership and what we owed him.

Q. So then what did you do?

A. From that period on there was a certain amount of work to be done to wine to finish it and prepare it for market. In the month of January and February I was seeking markets [70] whereby we could dispose of this wine.

Then as partners we got together and agreed that we would form a corporation of the Mills Winery, and that was done on March 4. At that time we agreed as partners that the whole inventory and the assets and liabilities would go into the corporation. We filed our closing income tax, set up books for the corporation beginning March 4.

Q. Where are the books?

A. The books——

Q. Up at the winery?

A. Partly; the bookkeeper in Los Gatos.



(Testimony of Paul Kershaw, Jr.)

Q. Do you have an office somewhere else?

A. Our bookkeeper has an office in Los Gatos. Our office is at the winery.

The Court: Go ahead, Mr. Boyle. I am sorry; I didn't think my questions would take this long.

May I call your attention to the fact that Exhibit 2-B is unexecuted? It refers to John Azevedo doing business as Mills Winery. It doesn't refer to any partnership.

Q. (By Mr. Boyle): Mr. Kershaw, from what source was the Capital National Bank of Sacramento paid back the \$440,000?

A. From the sale of wine.

Q. Of the 1945 crush?

A. Yes; which was sold between March and June of 1946. [71]

Q. And is it from the sale of the 1945 crush that we derive the income in issue here?

A. Yes.

Mr. Burnstein: What were you referring to, counsel, when you said "here"?

Mr. Boyle: This tax matter here.

Q. (By Mr. Boyle): I show you Paragraph 7 in the stipulation of facts and direct your attention to the bottom thereof, the bottom of the page, which says, "The agreed price of \$100,000 was paid as follows."

Do you see that? A. Yes.

Q. Is that the way the \$100,000—well, correction, \$110,000. Let me ask you, first of all, why did

(Testimony of Paul Kershaw, Jr.)

you pay John 110,000, when the adjusted basis was 100,000?

A. Well, he felt, with the amount of construction that the corporation was doing, had planned to do, we asked him to stay there and he felt he should receive 10,000 more than we originally agreed to, and it amounted to 110,000.

Q. He stayed on the premises?

A. That is right.

Q. This last payment was made July 4. Was he still on the premises then?      A. Yes. [72]

Q. It is stipulated that the source of these payments was out of the profits from the 1945 crush; is that your understanding?      A. Yes.

Mr. Boyle: Will you mark that for identification?

The Clerk: Exhibit E for Identification.

(The document above referred to was marked Respondent's Exhibit E for Identification.)

Q. (By Mr. Boyle): I show you Exhibit E for Identification, which purports to be the minutes of the first meeting of the board of directors of Mills Winery on March 20, 1946, and ask, is that your signature at the bottom thereof?

A. That is right.

Q. Is this a true and correct document or recordation of the minutes of that meeting?      A. Yes.

Mr. Boyle: I offer this in evidence, your Honor.

The Court: Any objection?

Mr. Burnstein: No, your Honor.

(Testimony of Paul Kershaw, Jr.)

The Court: E is received in evidence.

(The document above referred to was received in evidence as Respondent's Exhibit E.)

The Court: What are you offering this for?

Mr. Boyle: Merely as background, your Honor, and also [73] as a part of Petitioner's case to show they did have officers as of that date.

The Court: Part of respondent's case?

Mr. Boyle: Well, we are trying to give the facts that existed. I have another one to be marked.

The Court: Exhibit G for Identification.

(The document above referred to was marked Respondent's Exhibit G for Identification.)

Q. (By Mr. Boyle): I show you Exhibit G for Identification, which purports to be the minutes of a special meeting of the Board of Directors of Mills Winery on the 12th day of August, 1946, and ask is that your signature at the bottom of the last page?

A. That is right.

Q. Is this a true and correct copy of those minutes?

A. Yes.

Q. Directing your attention to page 3—

Mr. Burnstein: Well, if the Court please, I am going to object to any reference to the minutes until your Honor rules upon the admissibility of these for the purpose for which counsel intends to use them, which was just at the very end of the morning session.

This is one of those steps in that alternative plan of his that I would like to have an opportunity to

(Testimony of Paul Kershaw, Jr.)

discuss with your Honor. [74]

Mr. Boyle: I will offer this in evidence at this time.

Mr. Burnstein: Your Honor, if I may, I would like to find out for what purpose it is offered because if it is offered for the purpose of attempting to lay some foundation for an alternative procedure that Mr. Boyle discussed with your Honor before the noon recess, I respectfully believe that it is not admissible for that purpose.

The Court: He didn't discuss anything with me before the noon recess. He presented to the Court an alternative intention; there is a great difference between discussing anything with the Court and saying that you make an alternative contention.

This is F for identification?

Mr. Boyle: G for identification.

The Court: You have heard the objection of petitioner's counsel. What do you have to say about that?

Mr. Boyle: G for Identification is a recordation of the minutes of a meeting. It is actually in this case for several reasons. It has other meaning besides the alternative contention that respondent intends to make at the end of the trial.

The Court: Objection is overruled. Go ahead, Mr. Boyle.

Q. (By Mr. Boyle): Directing your attention to page 3, specifically to [75] the first paragraph at the top, would you please read the first sentence?

A. "Now, therefore, be it resolved that upon the

(Testimony of Paul Kershaw, Jr.)

issuance of a permit by the corporation commissioner, the department of investment for the issuance of such shares that Robert J. Azevedo and Paul Kershaw, Jr., shall pay to this corporation for the obtaining of a deed for the real property upon which the business is to be operated by this corporation is located, the sum of \$55,000 each, or a total of \$110,000 in cash."

Q. That is enough. Did you pay to the corporation \$110,000 in cash after August 12, 1946?

A. I have not.

The Court: I didn't hear you?

The Witness: I did not.

Mr. Boyle: I offer Exhibit G for Identification in evidence, if it was not received previously.

The Court: It was received previously. You offered it before. However, we will be clear about it. G is received in evidence.

(The document above referred to, marked Respondent's Exhibit G, was received in evidence.)

Mr. Boyle: I offer in evidence at this time photostatic copies of the individual income tax return of Robert Azevedo for the year 1946. [76]

The Court: Without objection that is received in evidence as Exhibit H.

Mr. Boyle: I offer in evidence the 1946 individual income tax return of Paul Kershaw, Jr.

Mr. Burnstein: No objection, your Honor.

The Court: Received as Exhibit I. in evidence.



(Testimony of Paul Kershaw, Jr.)

Mr. Boyle: I offer photostatic copy of the 1946 individual income tax return of Irene Kershaw.

The Court: Received as Exhibit J in evidence.

(The documents above referred to were received in evidence and marked Respondent's Exhibits J, H and I.)

Mr. Boyle: May I have this marked for identification, your Honor?

The Court: Are you going to offer this or ask some questions about it?

Mr. Boyle: I am going to ask some questions.

The Court: Do you have an Exhibit K?

Mr. Burnstein: There is a K in evidence, your Honor.

The Court: K is the other return. This will be L for identification.

(The document above referred to was marked Respondent's Exhibit L for Identification.)

Q. (By Mr. Boyle): Mr. Kershaw, I show you L for identification which purports to be the corporation return from 1120 of Mills [77] Winery for the fiscal year ending February 29, 1952; is that your signature on this return? A. Yes.

Q. Is this a correct return of the corporation for that fiscal year? A. That was amended.

The Court: Will you speak up, please, Mr. Kershaw? I have to hear you.

The Witness: I think this income tax report was amended.

(Testimony of Paul Kershaw, Jr.)

The Court: Well, it was a return of the corporation, is that right, and you identify it as such?

The Witness: It is.

Q. (By Mr. Boyle): Directing your attention to the balance sheet on the reverse of this return, on the back sheet, page four, and specifically to notes and accounts receivable, I ask you to give the amount shown opposite that account at the beginning of the taxable year.

Mr. Burnstein: If the Court please, I am going to object to any testimony in connection with what appears on the corporation tax return of 1952 for the ground that it is incompetent, irrelevant and immaterial, and also beyond the issues framed in these pleadings that are now before this Court. [78]

The Court: What do you believe the issues are to which this question might relate?

Mr. Burnstein: The issue might relate to the alternative contention that counsel discussed, or argued, or brought before this Court before the noon recess. That would be the only purpose of it, if the Court please.

The Court: The respondent's pleading was not well drawn. The petitioner's pleadings were not well drawn, and so counsel for each party has proceeded under a certain kind of misunderstanding about how far their pleadings should go.

There is a misunderstanding, in my opinion, and it is not an oversight. At the end of the taking of testimony I will allow counsel for the petitioner

(Testimony of Paul Kershaw, Jr.)

and counsel for the respondent to amend pleadings, so as to make the pleadings proper.

Therefore, with that understanding, I will let Mr. Boyle proceed with his point, and your objection I will overrule.

Go ahead, Mr. Boyle.

Q. (By Mr. Boyle): Mr. Kershaw, will you read the figure opposite the item, "Notes and accounts receivable," at the beginning of the taxable year March 1, 1951, and ending February 29, 1952?

A. "\$13,171.35."

Q. Will you read the figure opposite that same item, [79] "Notes and accounts receivable at the end of the taxable year"?

A. "110,171.35."

Q. Do you recall the transaction underlying the increase in the accounts receivable?

A. I don't know why. I would have to have other records.

Q. Directing your attention also to Schedule L, the balance sheet, and specifically to line 14 thereof, entitled "Capital Stock," I ask you to state the figure, if any, opposite that item at the beginning of the taxable year.

A. There is no figure.

Q. What is the figure opposite that item at the end of the taxable year?

A. \$110,000.

Q. Do you recall why \$110,000 was inserted opposite capital stock at the end of the taxable year?

A. Well, it is possible that the figure of \$110,000 could be what Robert Azevedo and Paul Kershaw, myself, owed the corporation that they borrowed from the corporation.

(Testimony of Paul Kershaw, Jr.)

The Court: Well, you know what capital stock means. Do you know what that entry calls for on this return? Do you know anything about accounting?

The Witness: No, I don't, your Honor.

By the Court:

Q. Capital stock on the balance sheet means the stock of the corporation which is issued and outstanding, do you see? [80] A. Yes.

Q. And stock can't be issued under the laws of the State of California, I believe, unless something is paid in for the stock, either property or money.

The question is, the question Mr. Boyle asked you, is why the balance sheet of the corporation shows no stock issued and outstanding at the beginning of the year, but does show stock issued and outstanding at the end of the year. There is no answer to that question.

Did you make up this return?

A. No, I didn't.

Q. It is signed by C. W. Smith, National Accounting Service. Where is the National Accounting Service located?

A. The office is in Los Gatos.

Q. Do they have a San Francisco office?

A. No.

Q. Was stock of the Mills Winery corporation ever issued to you? A. Yes.

Q. Do you have stock certificates? A. Yes.

Q. How many shares of stock do you have?

A. At the present time, your Honor?

(Testimony of Paul Kershaw, Jr.)

Q. No; perhaps more has been issued now. The first amount of stock that was issued to you, tell me how many [81] shares you got and when it was issued to you?

A. 1,000 shares at \$100 a share, which is held in escrow.

Q. It was held in escrow?                      A. It still is.

Q. And who is the escrow agent?

A. I believe in the office of Mr. Popper and Mr. Burnstein.

Q. In the attorney's office?

A. That is right.

Q. A thousand shares at a par value of \$100 a share is \$100,000, so that no certificates were issued even though the stock was held in escrow. Were any certificates issued in your name and in Robert's name?                      A. Yes; both names.

Q. Were they issued in your names?

A. The stock held in escrow was issued in our names.

Q. Is there an escrow agreement? There usually is an escrow agreement if you put anything in escrow?                      A. I think so.

Q. Do you know anything about that?

A. I am not too familiar with it.

Q. Why is the stock being held in escrow?

A. Because I don't think the State of California, the actual value of the winery would have to be proven before they would release the amount of stock that was issued. [82]



(Testimony of Paul Kershaw, Jr.)

Q. You haven't cleared with the California Corporation Commission?

A. On the amount of the value of the stock.

Q. You didn't in 1952, and you haven't up to the present time?      A. That is correct.

Mr. Burnstein: Your Honor, may I—

The Court: You might have to take the stand after awhile.

Mr. Burnstein: I can explain that, your Honor.

The Court: We are now at the point of trying to take testimony and get evidence in this case, and I don't want any more of these explanations from counsel. They have no evidenciary value. Have you some further questions, Mr. Boyle?

Mr. Boyle: I offer L for identification in evidence, your Honor, and request permission to withdraw that and submit a photostatic copy.

The Court: Any objection?

Mr. Burnstein: No objection, your Honor.

The Court: L is received in evidence, with leave to substitute a photostatic copy. We will let you take that afterwards.

(The document above referred to was received in evidence as Respondent's Exhibit L.)

Mr. Boyle: That is all I have, your Honor, unless [83] you have some desire that I pursue a certain course of questioning. That is all the questioning I have of this witness, otherwise.

The Court: They are contending that the corporation began doing business on March 4, 1946;

(Testimony of Paul Kershaw, Jr.)

respondent contends that the corporation didn't start doing business until August of 1946?

Mr. Boyle: That is right, your Honor.

The Court: What you need to do is to ask questions about that time area. You ought to have a few more questions about that. What was the evidence of the corporation starting business on March 4, 1946?

Mr. Burnstein: Your Honor, may I ask a question? We have some stipulated facts and I am just wondering whether your Honor has accepted that stipulation or whether or not we are disregarding it?

The reason I mention that, this question you proposed to Mr. Boyle, all of the things that we purport that would assist the corporate entity are in there, and I did not want to take unfair advantage of Mr. Boyle at this moment to asking these kinds of questions.

The Court: We have received this stipulation of facts in evidence, and we won't have any problem unless something comes up that is in conflict with this stipulation of facts. The Court has not rejected it. It stands as your [84] stipulation. This is all supplementary; there may be some corroboration involved in questioning this witness. There may be some disputation, but the witness is here to clarify anything that can be clarified.

Mr. Boyle: Well, it was to avoid any possible conflict between his testimony and the stipulated facts that I hesitate. However, if there is any mat-

(Testimony of Paul Kershaw, Jr.)

ter on which he can testify which will clarify or explain any of these acts, I wish to do that.

The Court: If anything came out in the testimony that was in conflict with your stipulation of facts, why, that would be a problem you could handle later. You might have made some error in your stipulation and you might have to amend it.

Mr. Burnstein?

Mr. Burnstein: Yes, your Honor.

The Court: Direct my attention, please, to some argument in the stipulation—some paragraph in the stipulation that you think covers the matter about which——

Mr. Burnstein: Yes, your Honor, Paragraph 10.

The Court: One piece of evidence that the corporation went into business is that on April 9, 1946, Mills Winery as a corporation executed an agreement with third parties?

Mr. Burnstein: Yes, your Honor; the further paragraph also in that same paragraph numbered ten. [85]

The Court: "Corporation entered into written agreements with Southern Pacific Railway Company."

By the way, Mr. Burnstein, don't you have another exhibit that is related to the agreement with the Southern Pacific Railroad Company?

Mr. Burnstein: I have those here now, your Honor, and I would like to offer both of those into evidence; those are the agreements of May 11 and

(Testimony of Paul Kershaw, Jr.)

May 23, of 1946, which are referred to in that paragraph, your Honor.

The Court: You have no objection, Mr. Boyle?

Mr. Boyle: No, your Honor.

The Court: I believe the next exhibit of the petitioner will be 11. Have you made a record of that?

Mr. Burnstein: 11-K was in evidence.

The Court: The agreement between the corporation and the Southern Pacific dated May 11, 1946, is received in evidence as Exhibit 12.

Mr. Boyle: If your Honor please, we have a 12.

The Court: Then that will be Exhibit 13. The agreement with the Southern Pacific dated May 23, 1946, is received in evidence as Exhibit 14.

Mr. Burnstein: Your Honor, may I also introduce into evidence at this time the agreement that is likewise referred to in Paragraph 10, this fruit pulping and fruit distilling agreement entered into between the corporation and I—— [86]

The Court: No objection? That was one of the stipulated exhibits.

Mr. Boyle: No objection.

The Court: This is a joint exhibit received in evidence as Exhibit 6-F.

(The documents above referred to were received in evidence and marked 13, 14 and 6-F.)

The Court: What else in your stipulation of facts relates to actions by the corporation?

Mr. Burnstein: Paragraph 13. I believe in a substantial portion thereof.

(Testimony of Paul Kershaw, Jr.)

The Court: What other paragraphs?

Mr. Burnstein: Paragraph 12, your Honor. I am sorry; I skipped over 12.

The Court: What else?

Mr. Burnstein: Paragraph 17.

The Court: Yes.

Mr. Burnstein: Paragraph 23.

The Court: I will read the first sentence to you of Paragraph 23; "All sales of wine made during the period March 1, 1946, to August 6, 1946, were picked up as corporation gross income."

Tell me what you mean by "picked up." Picked up on the books?

Mr. Burnstein: Picked up on the books, were reported [87] as corporate gross income.

The Court: And were reported in returns?

Mr. Burnstein: Yes, your Honor.

The Court: You will agree to that, Mr. Boyle? It is a stipulation—the expression "picked up" is ambiguous.

Mr. Boyle: We agree that it was picked up when the returns were filed. We have no knowledge as to the date; actually, as a daily transaction that was recorded.

The Court: Your agent has seen the books of the corporation, I suppose?

Mr. Boyle: He has.

The Court: Did he find that there were entries, that there were accounts opened on the books as of March 4?

Mr. Boyle: Well, we are into an area of con-



(Testimony of Paul Kershaw, Jr.)

fusion again, your Honor. I do not wish to be in the position of trying to make evidence, but my statements may do so. Our understanding was that the same books were maintained by the father, by the partnership and by the corporation.

I would be happy if the witness is able to recall exactly whether that was true or not, or whether there were different books and records.

Mr. Burnstein: Well, your Honor, may I say this? It was somewhat news to me that Mr. Boyle would make such a statement after we discussed this on many occasions, and in the light of his admission in the answer. We have alleged in [88] our petition in Paragraph 5-P, if I recall, that books were open for the corporation on March 4.

That was admitted in the answer, and then I discussed it with Mr. Boyle, and I said if this is not a fact I don't want to take advantage of an improper admission, and we finally determined just the other day that the revenue agent did see these books open as of March 4. I don't want to make evidence either.

The Court: We have run into that problem before that one set of books is kept and they are supposed to be the books for two or more entities.

Mr. Burnstein: That is not the case here.

Mr. Boyle: Mr. Burnstein stated in correctly. I did not wish to stipulate that books and records were opened up and therefore we didn't stipulate specifically in that regard. It was only because your

(Testimony of Paul Kershaw, Jr.)

Honor focused our attention on that point that we have made these statements. Actually we aren't in a position to state the minute details of the book-keeping system on or about March 4.

The Court: You have your pleadings there. Will you please, for the record, tell me what subparagraph of Paragraph 5 your petition deals with?

Mr. Burnstein: 5-P, "on or about March 4, 1946, the corporate books and accounts were opened," and so forth.

The Court: To use an expression like "picked up" in [89] a pleading or in a stipulation is very poor. It is a colloquial expression and is likely to be ambiguous. The respondent admits that all sales of wine made during that period were "picked up." Whether he picked you up on the use of that expression and said, "Well, I will agree when they were picked up," it could have been something that was done at a later date, as of March 4, 1946, but I will deal with that later. That appears to be an admission by the respondent.

Mr. Burnstein: I do not believe, your Honor, that there are any other exhibits that we wish to offer into evidence at this time.

The Court: We will go back to Mr. Boyle. Are there any other questions of this witness?

Mr. Boyle: No, your Honor.

The Court: You may inquire, Mr. Burnstein.

(Testimony of Paul Kershaw, Jr.)

**Cross-Examination**

By Mr. Burnstein:

Q. Mr. Kershaw, after March 4 of 1946, what were your duties and activities in connection with the corporate activities? Did you do anything in regard to working for the corporation?

A. Yes; I was taking care of the sales.

Q. And as a person taking care of the sales, was it your duty to contact other fruit processors or brokers or other persons in the food processing industry? [90]

A. Yes.

Q. And as you did contact these people, did you make any representation or statement for whom you were dealing?

A. Yes.

Q. What did you say, if anything?

A. Well, I told people who I contacted, like brokers, that we had a corporation of Mills Winery, certain wines to offer on the market.

Q. Were these the same people that you might have contacted or did contact when you were a partner with Robert J. Azevedo?

A. There were a couple parties, yes.

Q. And these parties that were the same parties——

The Court: Don't lead your witness. You are asking leading questions.

Mr. Burnstein: Yes, your Honor.

Q. (By Mr. Burnstein): And did you contact

(Testimony of Paul Kershaw, Jr.)

these same parties after the corporation was organized?      A. Yes.

Q. And when you contacted those parties after the corporation was organized, did you say anything to them in regard to the formation of a corporation?      A. Yes.

Q. And what, if anything, did you tell [91] them?

A. I told them I was an officer, vice president of the corporation, and had charge of the sales.

Q. And did you eventually sell this wine that was the inventory?      A. Yes.

Q. And in order to clarify that, when was all the wine, or substantially all the wine disposed of that was from the 1945 crush?

A. I believe by the end of June.

Mr. Boyle: What year?

The Witness: 1946.

Mr. Burnstein: I believe that is all.

The Court: You may step down.

(Witness excused.)

The Court: Mr. Burnstein is there something you would like to explain about the stock being held in escrow?

Mr. Burnstein: Yes, your Honor; if I may, I will be sworn.

The Court: Yes.

Whereupon,

ROBERT C. BURNSTEIN

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address for the [92] record.

The Witness: My name is Robert C. Burnstein; my address is 414-13th Street, Oakland, California.

Direct Examination

The Witness: On or about September 18, 1946, an application was filed before the Commissioner of Corporations of the State of California, the Department of Investments, for the issuance of stock to Mills Winery, a California corporation.

At the time the application was filed by reason of services that were rendered by the officers to the corporation, a request was made for the issuance of promotional stock, which was fixed on the face of the corporation minutes as being worth a certain sum.

The Commissioner under the Corporate Securities Act of the State of California, has a right to issue what is called promotional stock for services rendered in connection with the development, promotion and enhancement of the corporation. That permit was issued. However, since the promotional stock——



(Testimony of Robert C. Burnstein.)

By the Court:

Q. How much did they ask for, promotional stock, how many shares?

A. Approximately \$1,350,000 in promotional stock.

Q. The idea being that was to be issued to them for their services in promoting the corporation?

A. That is right. [93]

Q. They didn't have to put in any capital for that? A. No.

Q. To issue \$1,350,000? A. Yes.

Q. Which would be 13,500 shares if it had a par of 500?

A. No; your Honor, let me explain that. Mr. Kershaw was wrong, so your record is correct. There are 20,000 shares that is the authorized issue of this corporation at \$100 par value, the aggregate par value of this corporation is two million dollars.

Q. How do you get that?

A. 20,000 shares at \$100 par is two million.

Q. I don't follow you. I thought you meant the promotional stock?

A. No; that is the aggregate par value.

Q. How much of the authorized capital stock was issued?

A. All of the authorized capital stock was issued, two million dollars.

Q. To whom?

A. To Robert J. Azevedo as to one-half and Paul Kershaw, Jr., as to one-half, 10,000 shares

(Testimony of Robert C. Burnstein.)

each under a permit issued by the Commissioner of California.

Q. That is separate and apart from the promotional stock; is that right?

A. No; included in the 20,000 shares is the promotional—— [94]

Q. 20,000? A. Included within the——

Q. 20,000 shares includes the 13,500 shares of promotional stock?

A. Approximately that, your Honor. I could get you the exact figures if you wanted them. There was a little over a million dollars promotional stock issued.

Q. That would be around \$6,500 for the stock that would be issued for paid-in capital. That would be the difference between promotional stock and total authorized stock.

Well, go ahead with your story.

A. As a result of this type of application, the laws of the State of California require an escrow which does not require any written agreement; all it does require is that stock be handled and held by some person designated by the corporation which can't then be transferred by the holders of the stock which is in escrow unless the purchaser signs a written agreement stating that they understand the stock is in escrow and know the conditions of the escrow.

The conditions of the escrow under the Corporate Securities Act of California, and they are almost identical as that when the net worth of the cor-

(Testimony of Robert C. Burnstein.)

poration is equal to less than the par value of the stock; the promotional stock and all the other stock tied up with that must be held in escrow, and can't be then reissued out of escrow until an application has [95] been filed that the net worth of the corporation is equal to the outstanding par value of all stock.

Mills Winery, unfortunately, by many reverses, has not reached that point, and we are not eligible to apply for the release of stock in escrow.

Q. That explains that?

A. Yes, your Honor.

The Court: Would you like to ask any questions, Mr. Boyle?

Mr. Boyle: No, your Honor.

The Court: Thank you, Mr. Burnstein.

(Witness excused.)

The Court: Well, we have some exhibits here. I believe there is no more evidence to be presented?

Mr. Burnstein: That is right your Honor.

The Court: Mr. Burnstein, I think you did not understand that you must plead the statute of limitations. The exhibits show that the deficiency notice which was mailed on May 13, 1953, in 49929, and 49928 and 49896, all of those deficiency notices were mailed more than five years after the filing of the returns of Irene and Paul Kershaw and Robert Azevedo.

Therefore, the deficiencies are barred by the statute of limitations unless each taxpayer omitted

from gross income an amount properly includable therein which is in excess of 25% [96] of the amount of gross income stated in the return. In that event, under the provisions of Section 275-C for 1939 Code, the taxpayer assessed, and so forth, at any time within five years after the return was filed.

Well, my understanding of the time when the deficiency notice was issued must be wrong. I assumed that the deficiency notice was issued within five years after the return was filed and that three-year period expired. The regular period is three years. You didn't plead the statute of limitations in your petition, and you must do so.

Mr. Burnstein: Yes, your Honor.

The Court: And will you agree to amend your petition and properly plead the issue?

Mr. Burnstein: Yes, your Honor.

The Court: And is your office in Oakland?

Mr. Burnstein: Yes.

The Court: I do not like to ask you to come over again, but you could mail that to the Court. It would reach us and I am sure Mr. Boyle has no objection to your perfecting your pleading. Mr. Boyle, you would be allowed the usual time within which to amend your answer. You have proceeded this afternoon with the understanding that you have the burden of proof because of Section 275; is that not true?

Mr. Boyle: That is true, your Honor.

The Court: On the matter of your answer, I understand [97] that you have an alternative con-

tention. Do you expect to argue that on briefs and that you believe the issues drawn by the pleadings were broad enough for you to advance an alternative contention? We have been over that, and the Court is still of the opinion that you ought to amend your answer. You can amend your answer now on the basis of conforming to the evidence of record, if you wish to.

State your objection, if you believe you have one, Mr. Burnstein. I want to give you the opportunity to state your objection.

Mr. Burnstein: Yes, your Honor. I wish to state for the record that when a request is made to amend, of this type of amendment and the Court normally has the right to permit the amendment with wide discrepancy, and many cases have held that they may do it at the time of the hearing, I respectfully submit that those cases that permit your Honor to permit an amendment at the time of the hearing can only be done when there is evidence of surprise on the part of the Commissioner; that he has been taken by surprise by reason of certain evidence that has come out from depositions or other things of that nature.

I do not believe that the motion to amend of this type could be permitted by the Court in her discretion and within its discretion where there is no showing that this was not known by the Commissioner long before the issues were fixed and [98] raised by the various pleadings.

The Court: Mr. Burnstein, if this motion to amend the answer would put any burden of proof



on you, I would hesitate to grant it, but it is an affirmative pleading of the respondent in his answer, and he has the burden of proof of it.

Mr. Burnstein: Yes, your Honor.

The Court: And if he hasn't met his burden of proof, raising the point wouldn't do any good.

Mr. Burnstein: Quite true, your Honor.

The Court: As I understand it, he feels that this point is one that can be dealt with under the general evidence, under your general stipulation. You know what the point is that he has?

Mr. Burnstein: Yes, your Honor.

The Court: And you know that he is relying upon the stipulation of facts, and the evidence that he has before us. I think it is proper to allow him to amend his answer. If allowing him to amend his answer, Mr. Burnstein, really necessitates your introducing any evidence, and if you are not prepared to introduce that evidence that is something that I can consider. In this sort of thing we are concerned with proof.

Mr. Burnstein: Yes, your Honor. To be fair with Mr. Boyle, I don't have any evidence that I would introduce even if your Honor permitted the amendment. I will be very [99] honest and frank about that.

The Court: You don't need to worry about being so fair to Mr. Boyle. You want to be concerned about the Court because I don't want to have an issue before me to decide if there is going to be failure of proof. I want to be sure that I have given you the opportunity to present all the evidence that

you need to. That is my point, and if you needed to present some evidence and you couldn't do it, if I allowed Mr. Boyle to amend his answer, then I want to allow him to amend his answer.

I would say his proposal was untimely because it didn't give you time to introduce evidence, and I don't like to have issues before me which I decide on the basis of failure of proof. That is why I ask the question. But you say that you don't intend to offer any evidence on this, and that this is strictly a matter of getting our issues in a row, properly under the pleadings.

With that understanding, if you will ask to amend your answer orally, and then reduce that amendment to writing, you will have two things to cover in your amended answer, and you may get that to the Court at some point.

Mr. Boyle: If your Honor please, I request permission to amend my answer to include a reliance upon Section 275-C, due to the fact that petitioner is going to amend his petition to plead the statute of limitations. [100]

I further request permission to amend my answer to argue in the alternative a legal theory in this case, and my grounds for that are to amend the pleading to conform to the proof.

Mr. Burnstein: Your Honor, may I make one short statement in that regard?

The Court: Yes.

Mr. Burnstein: I believe, your Honor, if I understand Mr. Boyle correctly, if he is going to make an amendment to conform to the proof—maybe this

is not the time your Honor wants to hear this, but I don't think, from what he has, that he has sustained the burden of proof under this alternative plan of his, or this contention, and I respectfully submit that an affirmative defense must state some sort of affirmative cause of action, which it doesn't, from what I have heard here today, if the Court please.

Mr. Boyle: If your Honor please, I don't think, in the first place, that this is a situation where it is necessary to amend the pleadings. The alternative legal argument is going to produce less deficiency than is already asserted against these individuals and in many cases we argue alternatives without——

The Court: But your alternative argument is that each taxpayer has realized some taxable income in some way?

Mr. Boyle: That is right. [101]

The Court: And therefore he is taxable on it. How does he realize this taxable income in a lower amount, if your first proposition is not sustained?

Mr. Boyle: If your Honor please, that would be the purpose of the alternative argument, that if the Court holds against the Commissioner——

The Court: The reason why it has could be covered by the pleadings; the taxpayer has a right to defend himself against that alternative determination of realization of income. He has a right to say, "I didn't get that amount of income. I didn't get any amount of income."

Mr. Boyle: Well, if it would help your Honor,

this is not—we have discussed this previously and it is not new to the petitioner.

The Court: It is all new to me. If I read your pleadings, I don't get anything. I wish counsel would remember that when they come into Court they are finished dealing with each other. Now you are dealing with the Court, and the Court wants to know these things because the Court has to decide the question.

Mr. Boyle: This is a matter we couldn't stipulate to, and respondent is determined to go ahead in this fashion and introduce what——

The Court: You don't have to stipulate everything. What is the point? What is this alternative contention of yours, [102] anyway?

Mr. Boyle: The alternative contention will be, your Honor, that if the Court decides against the Respondent on the main issue—in other words, if the Court determines that the income we have in question was actually the income of the corporation and not of the individuals as asserted in the statutory notice, that then, nevertheless, the individuals did realize income to the extent that the corporation paid obligations of the individuals, namely, 55,000 for Robert Kershaw and 55,000 for Robert Azevedo, and 55,000 for Paul Kershaw.

The Court: Well, that is a new issue. If I owe Mr. Burnstein \$1,000 and you pay Mr. Burnstein \$1,000 and get him to discharge me from my obligation, I have realized income of \$1,000, but a fact has to be established there and that is that I owed Mr. Burnstein \$1,000.

Now, what indebtedness are you talking about? You say that if we regard the corporation as being a taxable entity in a period on March 4, 1946, beginning then, then three individuals or two individuals realize some income because the corporation paid some of their debts.

What debts are you talking about and what amount?

Mr. Boyle: If your Honor please, in the basic agreement of December, 1945, it was agreed that Robert Azevedo and Paul Kershaw, Jr., would pay John Azevedo \$100,000 as adjusted basis in the property. The evidence also shows that those [103] payments were made to John Azevedo during a period after March and, therefore, if the Court should hold that this was income from the corporation during that same period then the corporation in fact will have paid that amount.

The evidence further shows that——

The Court: Mr. Boyle, do you agree? You have stipulated and agreed that a partnership existed consisting of Robert and Mr. Kershaw?

Mr. Boyle: We have.

The Court: Have you stipulated to that?

Mr. Boyle: Yes.

The Court: Was that obligation an obligation of those individuals as members of the partnership, because if it was, if the partnership business was taken over by the corporation, the corporation would take over assets and liabilities, and it would issue stock to the members of the partnership in



some amount for the net value of the partnership business.

We get back to the court's concern which began this morning when I told you that although you have stipulated some facts you have not stipulated complete facts on topics such as this: How much corporate stock was issued to somebody, and for what? If one-half of the corporate stock was issued to Robert and one-half to Kershaw, what did they give to the corporation for that stock? Did they give money? Did they give the net worth of a partnership business, or what? [104]

There isn't any agreement that shows that one share of stock was issued to one of these people.

Mr. Boyle: Without regard to the stock, your Honor?

The Court: So you have entered into a stipulation which stipulates some facts, but it doesn't cover every possible fact. Well, all right. You are raising that issue in an amended answer.

I understand you are making a motion to amend your answer to that effect; your motion is granted. You will please reduce your proposal to writing. I must have written pleadings. You may file your amended answer as soon as convenient. It will be served on the petitioner. You have raised the question; you have the burden of proof on it.

If the evidence is insufficient to establish these things then you will lose for failure of proof and that is all we can do about it.

The Court: I think the dates for the briefs we have been using go something like this: Original

brief around August 19, but I believe Mr. Boyle had another case on my calendar, and probably he would like to have his brief in this case due a little later. So why don't I make it around the end of August?

What would be a day in August that doesn't come on Saturday or Sunday?

The Clerk: August 29 is a Monday, your Honor.

The Court: I notice that I am going to get a suggestion [105] on that, so I will wait. Mr. Boyle, what is your suggestion?

Mr. Boyle: If your Honor please, the case I had yesterday, the first brief is assigned September 12, and I have one more case after this, so I would request, if your Honor doesn't mind, a brief at a later date.

The Court: I would prefer giving you a date and if you can't make it, file a motion for an extension of time, otherwise it gets to be so late when the briefs are in.

August 29 for the original brief; they want 30 days, what would that be?

The Clerk: September 28.

The Court: September 28 for the reply brief. That is all. Please make a note about these amended pleadings that will be received. If you will wait a few minutes the Court will give you that return so you can have it photostated. Where will you send the photostats, to Washington?

Mr. Boyle: We will have it photostated here and I will give it to the clerk.

The Court: The clerk may not be here beyond

Friday, and if this session of the Court is extended beyond—or if it has ended, you send it to Washington in the usual way.

Mr. Boyle: Yes, your Honor.

The Court: We had 1-A and 2-B marked for Identification, and you want this in evidence. There is no objection as it is a joint exhibit. I want to understand once and for all, [106] is 1-A supposed to be an agreement of sale or is it supposed to be a partnership agreement?

Mr. Boyle: It is my understanding that it is an executory contract which purports to be an agreement of sale.

The Court: But it doesn't purport to be a partnership contract?

Mr. Boyle: That is true.

The Court: 1-A is received in evidence. What about 2-B? Does that purport to be a partnership agreement?

Mr. Boyle: No, your Honor; it has no significance to the respondent. It is merely put in as background to complete the written transaction.

The Court: May I call your attention to the fact that that is a carbon copy of something that shows no signatures; that there is no proof that that purported agreement was ever executed by anybody?

Mr. Boyle: Yes, your Honor.

The Court: What weight do you expect the Court to give to it?

Mr. Boyle: None, your Honor. The respondent attaches no significance to it except to——

The Court: Well, Mr. Boyle, don't be so agreeable. Whose exhibit is this, please? Is it Mr. Burnstein's?

Mr. Burnstein: It was originally suggested by Mr. Boyle. He asked me to get it for him and I did.

The Court: It is Mr. Boyle's exhibit? [107]

Mr. Burnstein: Yes; I said, "If you want it, you can have it." That is the most important exhibit on the revenue agent's report from the information we have, and I don't know why.

The Court: I am going to read this into the record. It has been marked for identification:

"Here is an agreement that purports to be an agreement made and entered into on the first of December, 1945, by John Azevedo, doing business as Mills Winery and Paul Kershaw, Jr., and Robert Azevedo. The consideration of John Azevedo selling Mills Winery and its assets to Paul Kershaw and Robert Azevedo, and under this agreement as part of the consideration, Paul Kershaw and Robert Azevedo agree to a sum and pay any judgment or judgments which may arise."

Mr. Kershaw has gone?

Mr. Burnstein: He went back to Sacramento, your Honor.

The Court: Was this agreement executed?

Mr. Burnstein: Your Honor, as I told Mr. Boyle previously——

The Court: Just answer my question.

Mr. Burnstein: I don't know.

The Court: Was an agreement of this kind ever executed?

Mr. Burnstein: I do not know. The first I heard of [108] it was from Mr. Donohue, the revenue agent.

The Court: Why don't you find those things out when you come in to try a case?

Mr. Burnstein: I didn't think it had any significance to our case. They wanted it and I said I would join in with the exhibit.

Mr. Boyle: It is agreeable that it be removed from the record.

The Court: Well, it is an important exhibit, Mr. Boyle.

Do you have a number twelve? Somebody told me we had No. 12.

Mr. Boyle: Yes; this could be 2.

The Court: I am talking about something else. Do you have a 12? We are missing Exhibit 12.

Mr. Boyle: If your Honor please, I believe that was the——

The Court: If we don't have a 12, I will change the number on that.

Mr. Boyle: That is the original of the 1946-'47 corporate return, if you recall.

The Court: Where is it?

Mr. Boyle: This should be 12 instead of 13.

The Court: I am Division 13 of this Court. All respondent's exhibits are marked with letters. That is your [109] Exhibit L. We don't have any 12. You misinformed me. Does L fit into this picture all right?

Mr. Boyle: Yes.



The Clerk: That number would just be missing then.

The Court: Let the record show that the agreement with Southern Pacific Company, May 11, 1946, is Exhibit 12 instead of 13, and the agreement of May 23, 1946, is Exhibit 13 and not 14.

We have lost sight of some exhibits.

Mr. Burnstein: There is one other exhibit I think you want to correct the number on.

The Court: No. You be seated for a few minutes and we will get the clerk to work this out.

I will receive 2-B in evidence for whatever its worth. It's a pretty poor exhibit, I must say.

We have all the exhibits now. You have the dates for your briefs and that will conclude the hearing.

Mr. Burnstein: May I ask a question?

The Court: No. We are finished.

Mr. Burnstein: There is one exhibit missing.

The Court: No, there is not. We will give you the numbers in a minute. That is all, thank you.

(Thereupon, at 4:30 p.m. the hearing in the above-entitled matter was concluded.) [110]

State of California,  
County of San Francisco—ss.

### Reporter's Certificate

I, Roland J. Rehrauer, 12 Geary, San Francisco, California, Reporter pro tempore of the Tax Court of the United States, Division 13, under its reporting contract, Do Hereby Certify:

That as such reporter I was present in Division 13 of the above-entitled Court, in session in the City of San Francisco, on Wednesday, the 29th day of June, 1955, and then and there took verbatim stenotype notes of all testimony, colloquy, statements, and every matter constituting the proceedings on the above date in the case of Robert Azevedo, Irene Kershaw and Paul Kershaw, Jr., Petitioners, Dockets Nos. 49896, 49928 and 49929, fully, completely and accurately, to the best of my ability, and that my stenotype notes are full, complete and accurate.

That the foregoing transcript, consisting of pages numbered 1 to 110, both inclusive, contains a complete, true and correct transcription of my said stenotype notes so taken as aforesaid, and a full, true and correct statement of the testimony given and of all of the proceedings had upon the trial of the above-entitled proceedings, to the best of my knowledge and ability.

July 6, 1955.

/s/ R. J. REHRAUER.

Filed July 13, 1955, T.C.U.S. [111]

[Title of Tax Court and Cause.]

Docket Nos. 49896, 49928, 49929

### CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of the Tax Court of the United States do hereby certify that the foregoing documents, 1 to 41, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation of Contents of Record" and "Designation of Additional Portions of Record," including Joint Exhibits 1-A, 2-B, 3-C, 4-D, 6-F and 11-K (Numbers 5, 7, 8, 9 and 10 not used); Petitioners' Exhibits 12 and 13, admitted in evidence and Respondent's Exhibits E, G, H, I, J, L, M, N and O, admitted in evidence, in the proceedings before the Tax Court of the United States docketed at the above numbers and in which the petitioners in the Tax Court proceedings have initiated appeals as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 27th day of August, 1956.

[Seal]      /s/ RALPH A. STARNES,

Chief Deputy Clerk, Tax  
Court of the United States.

[Endorsed]: No. 15270. United States Court of Appeals for the Ninth Circuit. Robert Azevedo, Irene Kershaw and Paul Kershaw, Jr., Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review Decisions of The Tax Court of the United States.

/s/ PAUL P. O'BRIEN,  
Clerk of the United States Court of Appeals for the  
Ninth Circuit.

Filed September 5, 1956.

Docketed September 13, 1956.

United States Court of Appeals  
for the Ninth Circuit

No. 15270

PAUL KERSHAW, JR.,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

STATEMENT OF POINTS

The Appellant, Paul Kershaw, Jr., pursuant to Rule 17, Subdivision "6" thereof, does hereby set forth a concise statement of the points on which he intends to rely and further does hereby designate the record on appeal which is material to the consideration of the appeal.

1. Paul Kershaw, Jr., the Appellant herein, and Robert Azevedo as Copartners under the firm name and style of "Mills Winery" were engaged in such business as a copartnership from August 1, 1945, to March 1, 1946.

2. The earnings from the operation of the business known as "Mills Winery" between March 4, 1946, and August 6, 1946, were taxable only to Mills Winery, a California corporation. The Appellant did not receive any constructive dividend nor any equivalent of cash by reason of the corporation, Mills Winery, paying the obligations assumed by it at the time of its incorporation.



3. The three-year statute of limitations on assessments and collections barred the assessment of the deficiency as determined against this Appellant and the Commissioner, the Appellee, has not sustained the burden of proof in proving any alleged omission from the gross income of the Appellant.

Dated September 12, 1956.

/s/ ROBERT C. BURNSTEIN,  
Attorney for Appellant.

[Endorsed]: Filed September 13, 1956, C.C.A.

United States Court of Appeals  
for the Ninth Circuit District

No. 15270

ROBERT AZEVEDO,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

PAUL KERSHAW, JR.,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

IRENE KERSHAW,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

### STIPULATION

It Is Hereby Stipulated by and between Counsel for the respective parties, that the Record on Appeal that is printed and prepared and all original exhibits which were introduced in the Tax Court which are being considered by the Court pursuant to previous stipulation without the necessity of reproducing the same shall be printed and prepared in connection with a companion case, Paul Ker-

shaw, Jr., vs. Commissioner of Internal Revenue; and that the record printed and prepared in connection with said case, namely, Paul Kershaw, Jr. vs. Commissioner of Internal Revenue, shall be the record on appeal to be used by the Court in determining the appeal of the above-entitled matter and that all records printed and produced in the said Paul Kershaw, Jr., vs. Commissioner of Internal Revenue matter shall be consolidated with this pending matter and an additional companion case, namely, Irene Kershaw vs. Commissioner of Internal Revenue.

Dated this 8th day of October, 1956.

/s/ ROBERT C. BURNSTEIN,  
Attorney for Appellant.

/s/ CHARLES K. RICE,  
Assistant Attorney General,  
Counsel for Appellee.

[Endorsed]: Filed October 17, 1956, C.C.A.

United States Court of Appeals  
for the Ninth Circuit District

No. 15270

ROBERT AZEVEDO,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

PAUL KERSHAW, JR.,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

IRENE KERSHAW,

Appellant,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Appellee.

STIPULATION

It Is Hereby Stipulated by and between Counsel for the Appellant and Appellee, that all of the exhibits introduced before the Tax Court, including all joint exhibits as well shall be considered by the above-entitled Court in their original form and that the said exhibits need not be reproduced for

the purpose of completing the record on appeal in the above-entitled matter.

Dated this 8th day of October, 1956.

ROBERT C. BURNSTEIN,  
Attorney for Appellant.

/s/ CHARLES K. RICE,  
Assistant Attorney General,  
Counsel for Appellee.

[Endorsed]: Filed October 17, 1956.